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A staff study entitled "The Tax Treatment of Earned Income", dealing with proposals for the reintroduction of an earned income credit in the Federal income tax system, was made public by the Treasury Department today. The proposals, growing out of a desire for improved equities and increased work incentives under the postwar individual income tax, are examined factually and analytically in the study. No policy recommendations are made.

Various methods of granting earned income credits are set forth, including methods used in foreign tax systems. Considerations for and against the equity and work-incentive aspects of earned income credits are weighed. Two administratively feasible methods of granting earned income credits are described and the Federal revenue loss under each is estimated. The complicating of tax tables and returns is among administrative difficulties which are discussed.

Several forms of earned income credit have been tried under the individual income tax in this country. The last of these was ended by Congress in 1943. None of these credits, according to the study, could be said to differentiate in favor of the lower brackets of earned income, since substantial amounts of unearned income were presumed to be earned. Also, none of the credits provided important incentives for business management, since above certain income levels -- $14,000 during the years 1934 through 1943 -- all income was presumed to be unearned and the amounts of tax savings from the credits were relatively small.

The two forms of earned income credit with which the study deals as examples are: (a) A tax credit of 2 percent of earned adjusted gross income; (b) the deduction of 10 percent of earned adjusted gross income in computing the final tax liability.

The 10 percent credit is more suitable for incentive purposes, the study states, because it provides significantly greater tax relief for those with higher incomes than does the 2 percent method.

Actual reductions in taxes paid would not differ greatly under these two methods for the bulk of the wage earners. Estimates presented in the study indicate that either method would reduce Federal revenues about $2,000,000,000 -- more precisely, $1,900,000,000 under the 2 percent tax credit and $2,100,000,000 under the 10 percent deduction. About 88 percent of the revenue reduction would go to taxpayers with net incomes of less than $5,000 under the 2 percent credit, and about 78 percent under the 10 percent method.

Either method would free approximately 4,500,000 wage and salary earners from income tax.

Arguments for and against an earned income credit from both the equity and the work-incentive viewpoints are analyzed in the study in detail. The equity arguments in favor of an earned income credit are based largely on the contentions that it provides a convenient and administratively feasible device to take account of (a) the absence of a depreciation allowance for labor, and (b) the smaller ability to pay tax out of earned income as compared with income from capital. Arguments against an earned income credit either deny that the tax structure discriminates against earned income, or contend that the credit is at best only a rough and perhaps outmoded approach toward achieving more equitable tax treatment for earned incomes.

Appraisal of the work-incentive aspects of a credit is even more difficult than of the equity aspects. Quantitative information is lacking, and the incentives to work of different taxpayers may be affected differently by the same taxes. Even though on balance the incentives to work may have been reduced by the current high rates of tax, the study indicates that there may be a real question whether total productive effort has been affected materially. Over a longer period of time, however, the momentum of the economic system might be slowed down by a persistent feeling that taxes were unreasonably high and unfairly distributed.

Although it is not clear that an earned income credit would noticeably increase the total labor effort, it might have a more significant impact on the supply of executive effort in the business field, where the high income taxes are said to have the greatest deterrent effects. Even in this area it is not clear that an earned income credit would greatly improve the overall supply of executives.

The study points out that there is also a question whether the earned income credit is a more effective method of stimulating incentives to greater production than alternative methods of tax reduction, such as tax rate reductions, exemption increases, elimination of double taxation of dividends, and the splitting of family incomes.

Reintroduction of an earned income credit would add complications to the existing individual income tax procedures, both for taxpayers and for the Bureau of Internal Revenue. The difficulties would be lessened if the first $5,000 of income from any source were to be treated as earned, since the credit could then be integrated into the present simplified tax table. However, this presumption would weaken the equity basis of the credit and add substantially to the revenue loss.

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THE TAX TREATMENT OF EARNED INCOME

Division of Tax Research, Treasury Department
November 1947

The Tax Treatment of Earned Income

One of the possible modifications of the Federal individual income tax structure in connection with general tax revision is an earned income credit. Interest in improving the equities and increasing the work incentives under the postwar individual income tax has redirected attention to the earned income credit as a method of implementing these policy objectives. This study examines various methods of granting earned income credits under both Federal and foreign tax systems. It discusses the considerations for and against the equity and work-incentive aspects of earned income credits. It presents estimates of revenue loss under two administratively feasible methods of granting earned income credits and discusses the nature of taxpayer compliance and administrative problems likely to be encountered. The study contains no policy recommendations and is confined to providing factual and analytic background material to assist in the formulation of such recommendations.

This study was prepared in the Individual Income Tax Section of the Division of Tax Research. The revenue estimates were supplied by the Office of the Technical Staff. In its preparation, valuable assistance and suggestions were received from other members of the Treasury tax staff, including the Office of Tax Legislative Counsel on legal matters and the Bureau of Internal Revenue on administrative matters.

This subject has also been considered by a committee composed of the technical tax staffs of the Treasury Department and the Joint Committee on Internal Revenue Taxation. An early draft of this study was made available to the committee and it has benefited at various points by the committee's discussions. However, none of the materials contained herein should be considered as representing the views of the staff of the Joint Committee on Internal Revenue Taxation.

Division of Tax Research
U. S. Treasury Department

The Tax Treatment of Earned Income

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The Tax Treatment of Earned Income

SUMMARY

1. Although the United States has not had any preferential tax treatment for earned income since 1943, there recently have been proposals for the reintroduction of an earned income credit. Some proponents are interested in the credit as a method of stimulating work incentives. Others stress the equity aspects of relief for earned income.

2. The United States had a credit for earned income during the years 1924-1931 and 1934-1943. In 1924 the credit was 25 percent of the normal tax on earned net income and during 1925-1931 it was 25 percent of the normal tax and surtax on earned net income. During 1934-1943 the credit took a different form, a deduction from net income of 10 percent of earned net income or net income, whichever was lower, and applied only to the normal tax (4 to 6 percent during this period). During these periods, the earned income credit could not be defended as a method of differentiating in favor of the lower brackets of earned income because substantial amounts of unearned income were presumed to be earned. Prior to 1934, \$5,000, and thereafter \$3,000, of income was presumed to be earned whether earned or not. Also, the credit could not be considered an important incentive for business management since above certain income levels (\$14,000 during 1934-1943) all income was presumed to be unearned and the amounts of tax saving from the credit were relatively small.

3. Special treatment of earned income is provided in the income taxes of Great Britain, Canada, and Australia. In Great Britain the credit is one-sixth of earned income (but not more than \$1,000) deductible from income subject to the standard rates. There is no general presumption that all unearned income below a certain amount is earned. The tax value of the credit reaches a maximum of \$450 at \$6,000 of earned income or about 20 percent of the tax on unearned income. However, it is not allowed for surtax, and it is viewed primarily as a wage earner's credit.

The Canadian credit takes the less usual form of a special tax of 4 percent on unearned income in excess of \$1,800. Below this amount all income is, in effect, treated as earned. This credit provides a comparatively mild amount of differentiation between earned and unearned incomes below \$5,000, but above this level it tends to increase in importance, since there is no upper limit to the recognition of earned income. Thus, at \$30,000 of net income, the amount of differentiation in favor of earned income is \$1,128 or 9 percent of the tax on unearned income.

The Australian credit has a lower limit of $648 below which all income is treated as earned and an upper limit of $16,200 above which all income is treated as unearned. Within these limits, the lower of two rate schedules is applied to earned income. The maximum credit is $814 at $16,200 of earned income or about 9 percent of the tax on unearned income. While the Australian credit may be viewed as more of an incentive credit for wage earners than the Canadian credit, it also provides more incentive to upper income earners than the British credit.

4. Proponents of an earned income credit present both equity and work incentive arguments to substantiate their requests for income tax differentiation in favor of earned income.

From an equity standpoint, the earned income credit may be viewed as a method of placing earned income on the same net income basis as unearned income in arriving at a homogeneous total of income that can be used as a fair measure of taxable capacity. Thus, it is contended that the recipient of earned income, unlike the recipient of income from capital, is not allowed a deduction for depreciation in spite of the fact that his productive capacities depreciate as he gets older and are ultimately exhausted. Also, it is claimed that the earned income recipient should be allowed a differential tax advantage in saving a fund for his old age, since he has less taxable capacity than the unearned income recipient who already has a capital fund on which he may draw. Further, the wage and salary earner's costs, monetary and psychic, of earning a living are said to be higher than the costs of the recipient of unearned income. Moreover, the person who earns a high salary during a short working life is not allowed the averaging of income extended to recipients of capital gains or business income. Finally, the trust arrangements, family partnerships, and other devices of tax reduction available to recipients of unearned income are said to be closed to recipients of earned income residing in common-law States. To take account of these extra expenses and burdens of earning an income, it is thought that the earned income credit provides a convenient and administratively feasible device.

From the incentive standpoint, an earned income credit is urged on the grounds that the work incentives of business managers need to be stimulated in the interest of assuring the continuance of a highly productive economy. The present type of tax system is thought to leave too small a step-up in compensation after taxes to assure the undertaking of the responsibility and effort needed to maintain and improve the level of business efficiency.

5. Two illustrative earned income credits which would be administratively feasible may be considered as useful methods of implementing the equity and incentive aspects of an earned income credit. These are: (a) a tax credit of 2 percent of earned adjusted gross income allowed against a tentative tax computed without such credit, and (b) the allowance of 10 percent of earned adjusted gross income as a deduction from income in computing the final tax liability.

For general equity purposes, the two approaches to the earned income credit do not differ greatly, since for both the bulk of the wage earners and the bulk of earned income the reductions in tax are not greatly different. However, the 10-percent credit is more suitable for incentive purposes because it provides significantly greater tax relief for those with higher incomes than does the 2-percent method. The estimated cost of the two earned income credits does not differ greatly. Assuming income payments of $166 billion, the 2-percent tax credit would cost about $1.9 billion or 11 percent of the estimated total tax liability; the 10-percent deduction would cost about $2.1 billion or 12 percent of the total tax liability. 1/

Under both methods most of the revenue cost would be allocated to taxpayers with net incomes of less than $5,000; about 88 percent under the 2-percent credit and about 78 percent under the 10-percent deduction. However, the somewhat larger revenue loss under the 10-percent method is attributable to the larger tax savings which would be given to those with incomes above $5,000. Thus, while the revenue loss to the under $5,000 group is roughly the same under either method ($1,688 million under the 2-percent credit and $1,622 million under the 10-percent deduction), the revenue loss allocated to those with incomes above $5,000 would be about twice as large under the 10-percent method ($470 million) as under the 2-percent method ($237 million). Under the 2-percent credit about 4.5 million wage and salary earners would be made entirely nontaxable, and under the 10-percent deduction about 4.3 million would be made nontaxable.

1/ The definition of income payments used here is the unrevised concept. See "National Income Supplement to Survey of Current Business," July 1947. The current level of income payments is higher than the $166 billion level assumed when these estimates were prepared. The higher level of income payments would raise the amounts of the revenue losses involved, but the percentages of the revenue losses to the total tax liability would not be changed appreciably.

6. In the past, the Federal earned income credits have been implemented with presumptions that (a) a minimum amount of income was earned even though the income was actually unearned, (b) all income above a specified amount was unearned even though the excess was actually earned, and (c) not more than 20 percent of trade or business income was earned.

If, in the event of adoption of an earned income credit, a minimum amount of income from any source were again presumed to be earned, the equity basis for the credit would be materially weakened, since there would be no tax differentiation in favor of earned as compared with unearned income below the presumption, and the revenue cost would be substantially increased. Thus, a presumption that the first $5,000 of income is earned would increase the revenue cost by somewhat more than $350 million, raising the cost of the 2-percent credit from $1.9 billion to $2.3 billion and of the 10-percent deduction from $2.1 billion to $2.5 billion. Under both methods, a slightly larger proportion of the total revenue loss would be allocated to taxpayers with net incomes of less than $5,000, and the number of taxpayers made nontaxable would increase to somewhat more than 4.5 million. Considerations in favor of such $5,000 presumption are the administrative and compliance simplicity which would result from incorporating the earned income credit into the simplified (Supplement T) tax table; the fact that most of the income (84 percent) of taxpayers with less than $5,000 of income is earned; and the resulting improvement in the formula that not more than 20 percent of trade or business income is earned.

The imposition of a top limit on earned income, above which the credit would not apply in order to implement the view that a relatively lower ability to pay income tax out of earned income applies only to "moderate" amounts of such income, would conflict with the incentive aspects of the credit. Thus, an earned income limit of $15,000 would mean that after realization of the benefit up to this amount no more incentive than now exists would be provided to executives considering increasing their efforts and responsibilities to earn more than this amount. Under this top limit, the revenue loss from the 2-percent credit would be decreased by only $22 million, reducing the total revenue loss to $1,903 million. The decrease in loss would be proportionately larger under the 10-percent deduction, but it would not be of crucial size from the policy viewpoint.

A certain proportion of trade or business income must be presumed to be earned because of the administrative impracticability of determining the portion actually earned. The portion of business net income attributable to the efforts of proprietors and partners probably varies with the size and nature of the business. Thus, a presumption that 20 percent of the business income is earned tends to understate the portion of profits attributable to wages of management in small, labor-using businesses. On the other hand, a 100-percent presumption tends to give an undue advantage to owners of large, capital-using businesses. In the past, the presumption that the first \$3,000 to \$5,000 of business income was earned tended to give a practical solution to the equity aspects of this problem. When this minimum income presumption is coupled with the 20-percent business income presumption, it treats a decreasing proportion of business income as earned (ranging from 100 percent to 20 percent) as size of trade or business net income increases. Since the trade or business income of taxable income recipients is estimated to be \$19 billion, the difference in revenue cost between a low- and high-percentage presumption would be relatively important. Under the 2-percent credit, assuming no minimum or maximum earned income presumption, a 20-percent business income presumption would account for a revenue loss of less than \$75 million and a 100-percent presumption would cost more than \$300 million.

7. Appraisal of the equity arguments for an earned income credit must necessarily rely on opinion and judgment, since factual answers to the complex issues are not available. The arguments against an earned income credit either deny that the tax structure discriminates against earned income, or contend that the credit is at best only a rough, and perhaps outmoded, approach toward achieving more equitable tax treatment for earned incomes. Thus, if earned incomes have special costs and expenses which ought to be allowed as deductions, then it is more equitable to allow them directly, since a credit would not differentiate between equal amounts of earned income with varying amounts of expense and depreciation. The depreciation argument is motivated by the desire to help earners save an old-age fund, but continuation and perfection of the social insurance system may be preferable to an earned income credit. As to equalizing the capital gain and loss carry-over advantages accorded unearned income, it would be more equitable to introduce adequate averaging for all incomes, both earned and unearned. Averaging would also solve the issue of variability of incomes. An earned income credit would not solve these vexatious problems. Neither can the credit be viewed as an effective offset to the tax-reducing opportunities available to unearned incomes in all States and earned incomes in community-property States. Here, too, there are more direct approaches, such as compulsory joint returns or allowing all incomes to be split equally between spouses. Finally, when all of the Federal, State and local taxes are considered, it is extremely difficult to say that earned incomes are treated less favorably than unearned incomes. On balance, one cannot measure the extent of the discrimination, if any exists.

8. Appraisal of the work-incentive aspects of a credit is even more difficult than in the case of the equity aspects owing to the lack of objective, quantitative information and because the incentives to work of different taxpayers may be affected differently by the same taxes.

There is no question but that some income taxpayers respond to either a high level of tax or high rate of graduation by a reduction in effort, and there is also substantial weight behind the general presumption that the individual income tax tends to decrease the incentive of individuals to earn additional income. Consequently, it may be reasoned that an earned income credit of the 10-percent-deduction type should tend to increase the incentive to work, since it reduces the level of tax and rate of graduation applicable to earned income.

Against these considerations, however, there must be weighed other considerations which may more or less offset them. Thus, in the same way that wartime needs brought forth wartime effort, the postwar transitional needs can be expected to induce some taxpayers to accept the continuation of high taxes without materially reducing their incentives to work. Another offsetting consideration is based on the high demand for income by individuals who desire to maintain relatively fixed or even increasing levels of consumption and saving. The incentives of these individuals tend to be increased rather than decreased by high taxes. A tax reduction would tend to reduce their incentives to work and slacken their efforts, since their objectives could be met with smaller incomes before tax. Moreover, even those whose incentives to work are decreased by taxes are limited in the extent to which they actually can reduce their efforts, since their positions and businesses must be protected from inroads likely to be made by their most aggressive competitors who are least affected by the high marginal tax rates. Finally, clients, customers and income-producing opportunities that are not taken by taxpayers whose incentives to work have been decreased by high taxes may be taken by their competitors whose incentives have not been decreased as much or may even have been increased, and by those whose evaluation of the future income from current undertakings tends to offset the decentive effects of currently high taxes.

In view of the foregoing considerations and in the absence of objective, quantitative information, there may be a real question whether the current high rates of tax have in the short-run actually reduced the total effort materially even though on balance the incentives to work may have been reduced. Over a longer period of time, the momentum of the economic system may be slowed down by a persistent feeling that taxes are unreasonably high and unfairly distributed. This feeling, however, is not exclusively within the purview of high-income taxpayers.

9. Although it is not clear that an earned income credit would noticeably increase the total labor effort, it might have a more significant impact on the supply of executive effort in the business field where the high income taxes are said to have the greatest decentive effect. A substantial earned income credit which significantly differentiates against unearned income would tend to draw a greater supply of executive effort into the tax-favored area away from the discriminated area, and would provide added inducement to existing executives to maintain and increase their efforts. However, there are also some offsetting considerations to these tendencies, in addition to those discussed above in connection with the effect of a credit on total effort. There are other important determinants of occupation besides remuneration among individuals with business executive capacities. Individuals in competing occupations may not be induced to shift their efforts into the business field by the earned income credit, since some would automatically obtain the credit and others might be successful in changing their form of remuneration so as to include more of it in the earned income category. A decreasing proportion of taxpayers' incomes is earned as the size of their incomes increases and, consequently, for many executives the benefits of the earned income credit may be weakened by the decentive effects of the tax differentiation against unearned income. Finally, even though the compensation after taxes is no longer as attractive to executives as formerly under low taxes, the alternative opportunities of employment may be still less attractive. Thus, even though the net effect of a substantial earned income credit may be to increase the supply of effort on the part of existing executives, it does not necessarily follow that there will be a great improvement in the overall supply of executives.

10. Insofar as an earned income credit differentiates against unearned income, there must also be considered the likelihood that incentives to invest are equally sensitive (or perhaps even more sensitive) to high taxes as incentives to work. There appear to be no good grounds for regarding investment as performing a less useful part than personal service in the productive process. Moreover, it is extremely difficult to classify economic activities from the incentive standpoint into those that merit tax concessions and those that do not. The active investor who directs his own capital now into one and then into another venture may be contributing as valuable personal services as the hired manager, and yet most of his income would not ordinarily be counted as earned. This inability to distinguish adequately between the earned and unearned portions of income jointly produced by effort and capital tends to limit the usefulness of the earned income credit for work-incentive purposes.

11. There is also a question whether the earned income credit is a more effective method of stimulating incentives to greater production than alternative methods of reducing taxes. General individual income tax rate reduction appears to be a more flexible way of approaching the tax problems of incentives to work and invest. The earned income credit has a disadvantage compared with rate reduction in that it must necessarily give a greater portion of the tax decrease to low-income taxpayers who may need relatively little tax reduction to stimulate their incentives to work compared with the higher income taxpayers.

An increase in personal exemptions would give the greatest relative amount of tax relief to the lower income groups without distinguishing between earned and unearned incomes. Indirectly, by increasing the demand of the mass of income taxpayers for goods and services, it would normally tend to stimulate work and investment incentives.

The proposal to split family incomes could be expected to provide some stimulation of incentives to work and invest because all of the tax decrease would go to taxpayers whose incomes fall above the first bracket, the chief beneficiaries being middle- and upper-income married couples residing in common-law States who receive all or most of their incomes from earnings.

Although the reduction or elimination of the double taxation of dividends runs counter to the equity implications of an earned income credit, it would not necessarily conflict with the incentive aspects since higher income taxpayers tend to receive both earned and unearned incomes. As substitutes for rate reductions, however, both the earned income credit and the dividend credit have the disadvantage of giving the rate structure a nominally high appearance which may have an undesirable psychological effect on incentives.

12. The reintroduction of an earned income credit would add complications to the existing individual income tax procedures from both the viewpoints of taxpayer compliance and of administration by the Bureau of Internal Revenue. Basing the credit on earned adjusted gross income rather than earned net income would be the most administratively practical method under present procedures. Substantial additional simplification could be obtained if the first $5,000 of income from any source were to be treated as earned, since the credit could then be integrated into the simplified (Supplement T) tax table. However, this minimum income presumption would weaken the equity basis of the credit and would add substantially to the revenue cost.

For administrative purposes, Form 1040 and the instructions would need to be revised and expanded to permit the segregation of the earned portions of incomes appearing in various income schedules, the aggregation of such earned incomes, and the computation of the credit. These changes would tend to complicate the forms and instructions.

In the absence of the $5,000 minimum income presumption, the simplified Form W-2, used by over 20 million taxpayers, could be kept virtually as simple as it is now, if the small category of unwithheld income, some times reported on these returns, consisting of up to $100 of wages, interest, and dividends were presumed to be earned. Since the maximum tax benefit a taxpayer could receive from this presumption would be only about $2, the administrative advantages would seem to outweigh the equity and revenue arguments which might be raised in opposition.

The Tax Treatment of Earned Income

I. Introduction

Since the enactment of the Revenue Act of 1943 there has been no special individual income tax treatment for earned income. Recently there have been several proposals for the reintroduction of an earned income credit. Some proponents are interested in the credit as a method of stimulating the work incentives of business executives. 1/ Some stress the equity aspects of relief for earned income, although the incentive effects are also listed in its favor. 2/ Others conclude that its usefulness is limited to the lower income brackets, and propose rate reductions at the higher income levels for work and investment incentive purposes. 3/

Labor has not been sponsoring an earned income credit in recent years. Apparently, its primary interest is to increase personal exemptions and to make them more effective by a system of carry-overs of unused exemptions. 4/

1/ Gen. Browning, Albert J. reported in the Wall Street Journal, March 5, 1946 and March 20, 1946. Investment Bankers Association, reported in the New York Times, May 22, 1947, p. 41.

2/ Chamber of Commerce of the United States, Federal Expenditure and Tax Policies, December 1946, pp. 24-26, Parker, Lovell H. Hearings on H.R. 1, Committee on Finance, 80th Cong., 1st Sess., pp. 351-352.

3/ Lutz, Harley L. The Tax Review, June 1946, p. 25.

4/ Repeal of the earned income credit was opposed in 1943 by Mr. Philip Murray, President of the Congress of Industrial Organizations (Hearings on Revenue Revision of 1943, Ways and Means Committee, 78th Cong., 1st Sess., pp. 921-922), and by the Executive Council of the American Federation of Labor (Report of the Executive Council of the American Federation of Labor to the Sixty-fourth Annual Convention, November 20, 1944, p. 68). The 1945 tax proposals of the C.I.O. and the National Lawyers Guild did not include proposals for an earned income credit (Hearings on Revenue Act of 1945, Senate Finance Committee, 79th Cong., 1st Sess., pp. 105-106, 124-125), and the Report of the Executive Council of the American Federation of Labor (Sixty-fifth Convention, October 7, 1946, p. 189) did not include a recommendation for the reintroduction of an earned income credit. Similarly, the recent tax statements of the representatives of the C.I.O. and the American Federation of Labor before the Committee on Finance did not include reference to an earned income credit, Hearings on H.R. 1, op. cit., pp. 251-253, 580-582.

Historically, there has never been an earned income credit in this country or in the United Kingdom, Canada and Australia designed to give business executives special relief from the full impact of the income taxes. But each of these countries has provided a credit to differentiate in favor of incomes earned from direct, personal effort as distinguished from incomes received by way of return on capital. The methods used for granting the credits have, for the most part, resulted in directing the tax relief to the lower income taxpayers.

II. American systems of differentiation

The present income tax law in the United States dates from 1913, but not until 1924 was provision made for an earned income credit. This tax credit, which at first was 25 percent of the normal tax on earned net income, was extended for the period 1925-1931 to apply to both the normal tax and surtax.

The normal tax for 1924 was mildly graduated and, consequently, the tax value of the earned income credit increased at a somewhat faster rate than income. The tax value of the credit for the years 1925-31 increased at a greater rate because it applied to the combined normal tax and surtax. However, the effect of graduated rates was not very substantial because each act provided an upper limit to the amount of income which could be considered as earned in computing the credit. In 1924, this limit was $10,000; during 1925-27, $20,000; and during 1928-1931, it was $30,000. Over the range of earned income allowed in computing the credit, the combined normal tax and surtax rates were graduated from 2 to 6 percent in 1924; 1-1/2 to 9 percent during 1925-1927; and 1-1/2 to 13 percent during 1928-1931. 1/ The maximum earned income credit for a married person, without dependents, was $55 in 1924; $206 during 1925-27; and $496 during 1928-31. 2/ The differential tax aspects of the credit were even less than indicated by these amounts, however, because certain amounts of unearned income were presumed to be earned. 3/

1/ The range was 1/2 to 12 percent under the reduced rates provided for 1929 by Joint Resolution of Congress.

2/ The maximum earned income credit for single persons without dependents was $75 in 1924; $231 in 1925-1927; and $521 in 1928-1931.

3/ See Table 1 which shows the "difference in tax" to be a smaller amount than the "maximum earned income credit." The difference in tax is smaller than the maximum credit by an amount equal to the tax value of the earned income presumption.

The earned income credit was eliminated for the years 1932 and 1933 as part of the effort to sustain the Federal revenues during the depression. In 1934, a credit was restored in the form of an allowance against net income as compared with the previous credit against tax. The new credit was either 10 percent of the amount of earned net income not in excess of $14,000 or 10 percent of the entire net income, whichever was lower. 1/ Since it was allowed only for normal tax, which during the years 1934-43 was either 4 or 6 percent, the maximum amount of earned income credit never exceeded $84. The credit was finally repealed by the Revenue Act of 1943, effective in 1944.

In the past, the earned income credit could not lay claim to importance as an incentive for business management, for the upper incomes were excluded, and the amounts involved were relatively small. For a married person, the maximum credit never exceeded $496 prior to 1934 and never more than $84 after 1934. Moreover, during the Twenties, the tax liabilities were so low that although the credit approximated 25 percent of the tax liability on unearned income at the $30,000 income level, the tax difference in favor of earned income added only about 1 to 2 percent to the net earned income after tax. 2/

The earned income credit, during these periods, could not be defended as a method of differentiating in favor of the lower brackets of earned income, because substantial amounts of unearned income were presumed to be earned. Prior to 1934, this amount was $5,000, and thereafter $3,000. Consequently, the source of income made no difference except in the income areas between the presumption of $5,000 and the upper limit of $10,000 in 1924; between $5,000 and $20,000 during 1925-27; between $5,000 and $30,000 during 1928-1931; and between $3,000 and $14,000 during 1934-1943. In the lower areas of the income scale, the earned income credits, throughout their history, failed to accomplish anything over and above what could have been achieved by a downward adjustment in rates or upward adjustment in exemptions; since everyone got it, nobody received a differential advantage. The Treasury felt that this kind of earned income credit served no useful purpose and, in 1943, repeal was recommended in the interest of simplification.

1/ The entire net income could be substantially less than earned net income in the case of an individual with capital or business losses.

2/ See Table 1.

III. Foreign systems of differentiation

In the light of the foregoing discussion of American experience with an earned income credit, certain differences in the systems of differentiation developed under some of the foreign tax laws may be noted.

The British credit of one-sixth of earned income cannot exceed $1,000 as an allowance against income subject to the standard rates. It is not allowed for surtax and it is viewed mainly as a worker's credit. Unlike the former American credit, it does not contain a broad presumption that a certain amount of income is earned, but starts with the first dollar of income actually earned. 1/ Like the former American credit, it ceases to be applicable beyond an upper limit, $6,000. This limit and the percentage of earned income allowed have varied from time to time in response to changing revenue requirements and tax policies.

The Canadian system of differentiation between earned and unearned income takes the less usual form of a special tax of 4 percent on unearned income. It is unlike the British credit because the first $1,800 of income from any source is exempted from the 4-percent tax and, therefore, it is in effect treated as earned. Another important difference is that the Canadian method of differentiation now has no upper limit on the amount of income which is treated as earned. Prior to the taxable year 1941, however, all income in excess of $14,000 was treated as unearned.

The Australian system of differentiation is, in a sense, a cross between the British and Canadian systems. The Australian law has both a lower limit of $648 below which all income is regarded as earned and a top limit of $16,200 above which all income is treated as unearned. Within these limits differentiation in favor of earned income is accomplished by applying two separate rate scales, the lower one to earned income. 2/

1/ A credit of five-sixths of earned income is also allowed a working wife. This allowance increases the marital exemption by a maximum of $440 when the wife's earned income is $528 or over. In the case of persons 65 years or over the first $2,000 of income is also treated as earned whether earned or not.

2/ That is, in determining the taxpayer's liability, the Taxation Department computes two tenative taxes on his total income: a) under the earned income schedule, and b) under the unearned income schedule. Then the average rates determined from each of these two tentative taxes are applied to the appropriate amounts of earned and unearned income, respectively, to find the aggregate tax liability.

In Great Britain the maximum amount of differentiation in favor of earned income is $450 1/at $6,000 of earned income, or about 20 percent of the tax on unearned income and about 12 percent of the unearned income remaining after tax. Under the Canadian law there is no maximum, 4 percent being allowed in favor of earned income without an upper limit. However, at $30,000 of net income the amount of differentiation is $1,128 in favor of earned income, which is equal to 9 percent of the tax on unearned income and about 6 percent of the unearned income left after tax. In Australia, the maximum credit of $814 at $16,200 of earned net income is about 9 percent of the tax on an equal amount of unearned income, and about 11 percent of the unearned income left after tax. 2/

The comparative work incentive aspects of these three different earned income credits are difficult to judge. Table 3 presents figures which indicate that the United Kingdom and Australian credits are of a size likely to stimulate the work incentives of wage earners, provided the demand for additional wage income (under $5,000) is damped by the high rates of tax in these two countries. Moreover, the Australian credit probably has a comparatively greater stimulating effect than that of United Kingdom above the $5,000 earned income level. The incentive effect of the Canadian credit appears to be comparatively mild below $5,000, but above this level it increases in relative importance.

IV. Bases for an earned income credit

A. Equity arguments favoring an earned income credit

In an historical sense, it is perhaps less accurate to view the earned income credit as a method of differentiating the income tax in favor of earned income than it is to regard it as a provision for equalization. That is, historically the credit may more properly be viewed as a way of placing earned income on the same footing as unearned income in striving for a homogeneous total of income that can be used as an appropriate index of taxable capacity.

A goal under the income tax law in this country is to reduce all the different types or sources of income to a common denominator of taxable capacity by allowing with respect to each type the costs and expenses that can properly be regarded as incident to the acquisition of income. But even after all the various costs and expenses are

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1/ $648 if the full working wife credit is considered.
2/ See Table 2.

allowed, some of the sources of income may still have certain peculiar characteristics which may need to be taken into account before aggregation and subjection to a uniform system of graduated rates. This is recognized, for example, with respect to long-term capital gains. Here the income may have accumulated over a substantial period and, because its realization is "bunched," it is accorded a reduced rate. Certain peculiar characteristics are recognized also with respect to business income which is accorded partial averaging by means of loss carry-overs. The proponents of an earned income credit generally hold that there are also peculiarities of earned income that call for some special adjustment before it can be included in the tax base on the same footing with unearned income.

In the past, a number of reasons have been presented in support of the contention that a special credit for earned income is needed before the taxable capacity of such income can be considered equivalent to that of unearned income. First, earned income is said to be net to a lesser degree than unearned income. The recipient of income from direct personal effort, unlike the recipient of income from capital, is not allowed a deduction for depreciation. It is maintained that a similar deduction should be granted to recipients of earned income since their productive capacities decline with age and are ultimately exhausted. The determination of the proper amount of such deductions would be extremely difficult, if not entirely impracticable. As a practicable substitute, an earned income credit is urged in the attempt to defray some part of the decline in value of the worker.

Moreover, since the recipient of unearned income already has a fund of capital on which to draw, his taxable capacity is greater than that of the person who lives entirely on earned income. The latter must save to meet extraordinary expenses and provide for his old age and for his heirs. The former already has savings and income to meet these needs.

Further, a wage earner's living expenses may be higher than those of an individual with a like amount of income living on interest or dividends, because the wage earner may be compelled to reside in an expensive area to be near his place of employment. Similarly, it is sometimes maintained that high-salaried executives in order to maintain their prestige in business circles must often support a substantially higher plane of living than they would voluntarily undertake. Such extra costs of living are not deductible from the wage or salary earner's income for tax purposes. Also, the recipient of earned income often does not have the leisure to shop carefully. Such additional expenditures introduce differences in the ability-to-pay income taxes among individuals with the same nominal income. 1/ Thus, an earned income credit is urged in lieu of special deductions for any additional expense of earning income, since these expenses would be difficult to measure and administer.

It has also been maintained that earning income involves greater psychic cost or sacrifice than the passive receipt of unearned income, because working is less pleasurable than alternative pursuits permitted by leisure. To the extent that this is the case, special relief for earned income would be warranted from the equity standpoint.

Although earned income appears to fluctuate more than unearned income, only unearned and business incomes enjoy the averaging effects of loss carry-overs and capital gains treatment. Consequently, the annual taxation of earned income may produce a heavier burden than is imposed on unearned income. Further, many of the larger earned incomes, those of business executives, movie stars and professional athletes, for example, are often temporary. Many of these earners can expect their high incomes to last perhaps less than a decade. Such "bunched" incomes are hit especially hard owing to the operation of progressive rates. That is, under the present system of determining income tax liability on an annual accounting basis, the more variable and the more "bunched" incomes are taxed more heavily over a period of years than the evenly distributed, stable incomes. 2/ The same progressive rates applied to average lifetime earnings, for example, would permit most taxpayers to enjoy a substantially higher proportion of their

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1/ Relief for earned income has also been advocated on the grounds that it would equalize the tax burden between the family where the wife is gainfully employed and the family where the wife contributes to real income by her full-time occupation with the housework. In the former case, aside from the decreased housework performed by the working wife, there may be added expenses of domestic help and insufficient time for careful shopping which do not arise in the latter case. However, a general earned income credit would not solve this problem, for where the earned incomes of these two types of family are equal they would get the same amount of credit. Thus, a special working-wife credit would be necessary to handle this problem.

2/ Section 107 of the Internal Revenue Code, in effect, provides for the averaging of income earned over a period of three or more years when at least 80 percent of such earnings are received in one year.

aggregate lifetime incomes. Unearned income, in general, seems to receive more favorable treatment than earned income because of the averaging effects of loss carry-overs and capital gains as well as the tendency toward less fluctuation.

Finally, except in community-property States, recipients of earned income do not have the same opportunities as individuals with unearned income to avoid the full impact of the higher progressive rates. The recipients of unearned income can frequently manouver into one tax haven or another, by using trust arrangements, and by otherwise splitting the property and income among family members. Such avenues of escape are largely closed to the earnings of business executives and others with substantial amounts of earned income. Temporary successes, such as the use of tax-inspired family partnerships, have usually come to grief. 1/

B. Incentive arguments favoring an earned income credit

Recently, representatives of business executives have urged an earned income credit as a method of reducing the income tax for work incentive purposes. It is claimed that under high tax rates business managers cannot be expected to contribute their utmost to the expansion of business. The very existence of a dynamic economy and the future development of the country are said to hinge upon the adoption of measures to relieve business managers from their heavy tax burdens. The tax system should leave them with ample prospects of improving their economic positions as they climb from job to job up the scale of ever-increasing responsibility. The present type of tax system is said to leave too small a step-up in the compensation after taxes of a lesser official as he moves up to become president of the firm.

A few illustrations may more clearly indicate the nature of this problem. Under present law, 2/ the junior executive who is married but without dependents and gets a chance to move up from a $5,000 to

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1/ Lucas v. Earl, 281 U.S. 111; Commissioner of Internal Revenue v. Tower, 327 U.S. 280; Lusthaus v. Commissioner of Internal Revenue, 327 U.S. 293. See also the Division of Tax Research study entitled "The Tax Treatment of Family Income," June 1947, Appendix A.

2/ Internal Revenue Code as amended by the Revenue Act of 1945.

a $10,000 job can keep over three-fourths of the increase. 1/ If he moves from a $10,000 to a $15,000 position, he can still keep more than two-thirds of the $5,000 raise. The more seasoned executive, who sees a chance of making $25,000 instead of $15,000, knows he can keep somewhat less than $6,000 of the additional $10,000. However, the $35,000 executive of today who is evaluating a $50,000 offer also knows that he can keep only a little more than $6,000 of the $15,000 increase. The high-priced executive who moves up from the $75,000 to the $100,000 level before taxes moves up only $7,500 after taxes to about $45,000 from about $37,500. The $50,000 difference between the $50,000 and the $100,000 executives before taxes is whittled down to a difference of about $16,000 by the income tax, leaving the two executives with respective amounts of income after tax of about $29,000 compared with about $45,000. 2/

V. Cost and impact of an earned income credit

Before attempting to appraise the equity and incentive aspects of an earned income credit, it is necessary to consider the size of revenue loss involved and the effects on the distribution of the income tax burden.

As indicated above in the sections discussing the use of earned income credits in the United States and certain foreign countries, there are a number of methods available for reducing the relative tax burden on earned income under the individual income tax. As a practical matter, however, the selection of methods is limited by the desirability of fitting the earned income credit within the administrative requirements of the existing individual income tax structure. Two illustrative methods which appear to be administratively feasible are: (1) a credit of 2 percent of earned adjusted gross income to be allowed against a tax tentatively computed without such credit, and (2) the allowance of 10 percent of earned adjusted gross income as a deduction from income in arriving at final tax liability. 3/

1/ See Table 4, the "present law" group of tax computations. In computing tax under present law, it was assumed that net income is nine-tenths of adjusted gross income at all income levels, and that salary was the sole source of income. If net income is more than nine-tenths of adjusted gross income, the taxes would be larger and the amounts left after taxes would be smaller than illustrated.

2/ Derived from Table 4.

3/ In both cases earned adjusted gross income has been selected as the basis for measuring the earned income credit since over 80 percent of the individual income taxpayers use either Form W-2 or the Supplement T tax table method of determining tax liability and do not compute their net incomes under present procedures. Consequently, to require these taxpayers to find their net incomes for purposes of the credit would introduce undesirable complications for both the taxpayer and the Bureau of Internal Revenue. The compliance and administrative aspects of an earned income credit are more fully discussed in Section VII, below.

A. Distribution of tax burden under illustrative earned income credits

The method of allowing 2 percent of earned adjusted gross income as a credit would provide proportionately greater tax decreases at the lower income levels than at the higher income levels. Thus, for a married wage earner with no dependents and with wages of $3,000, the tax decrease would be $60 or about 19 percent of the present law tax. The percentage of tax decrease resulting from the credit would be reduced to about 11 percent at the $10,000 level of earnings, and to roughly 7 percent at the $25,000 salary level. Above this level the percentage tax decrease would decline to roughly 4 percent between $75,000 and $100,000 and to roughly 3 percent between $150,000 and $200,000. 1/

The tax decreases when expressed as a percentage of adjusted gross income remaining after the present law tax would result in increases in disposable income of from 2 percent to 3 percent between the $3,000 to $25,000 level of earnings; increases of 3 percent to 4 percent in disposable income between the $35,000 and $75,000 salary levels; and from 4 percent to 6 percent between the $100,000 and $200,000 levels of earnings. 1/ These figures indicate the increases in income after tax which would be available to meet any special expenses of earning income. This method probably could not be expected to add appreciably to the incentives to work since it would reduce the taxes applicable to additional earnings or increase disposable income by only 2 percent of such extra earnings. 2/

The provision of an earned income credit by means of a deduction of 10 percent of earned adjusted gross income, however, would result in noticeably larger amounts of credit for the higher income earners. The tax decrease at the $3,000 level would be about 16 percent of present law tax; about 14 percent at the $10,000 level; about 15 percent at the $25,000 level; about 13 percent at the $75,000 to $100,000 level; and roughly 12 percent at the $150,000 to $200,000 levels. 1/

The increase in earned income after present law tax is also noticeably different under this method of allowing an earned income credit from that under the 2-percent tax credit, rising from about 2 percent to about 7 percent between $3,000 and $25,000, to 10 percent at the $50,000 level, 16 percent at the $100,000 level, and 22 percent at the $200,000 level. 1/

1/ See Table 5.
2/ That is, excepting taxpayers at the lowest part of the income scale. See Table 4.

Table 6 shows that this method would allow somewhat smaller tax decreases for wage earners below the $5,800 level than under the 2-percent tax credit, and that it would provide increasingly larger amounts of tax decreases for executives and other high income earners. The differences between these two illustrative methods indicate that a credit along the lines of the 10-percent-deduction method would be more suitable for work incentive purposes than one of the 2-percent-tax-credit type, since it gives appreciably greater tax relief for the higher earned incomes.

It should also be noted that the method of crediting a given percentage, such as 2 percent, of earned income from a tentative tax implies that the additional sacrifices and expenses incurred in earning additional income increase proportionately as earned income increases. A deduction from income, such as 10 percent of earned income, implies that the additional sacrifices and expenses incurred in earning additional income increase more than proportionately as earned income increases. The deduction method is more consistent with the generally accepted view that the additional units of effort required to earn additional income tend to have increasing disutility.

B. Cost of illustrative earned income credits

Although the impact of the two illustrative methods on the tax burdens at various income levels would differ significantly, the cost of the two plans would not differ greatly. Assuming income payments of $166 billion, 1/ the 2-percent tax credit would cost about $1.9 billion or 11 percent of the estimated total tax liability; the 10-percent deduction would cost about $2.1 billion or 12 percent of the total tax liability. 2/

The distribution of the revenue loss by income levels would roughly parallel the distribution of the earned adjusted gross income reported by taxable income recipients. The estimates in Table 7 show that approximately 77 percent of the total adjusted gross income reported by taxable income recipients is attributable to earned adjusted gross income. However, earned income accounts for about 84 percent of the total income of the net income group under $5,000, and only about 48 percent of the total income of the net income group above $5,000. Moreover, the proportion of total adjusted gross income accounted for by earned income drops rapidly from about 65 percent for the net income class $5,000 to $10,000 to less than 25 percent for the income class

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1/ The definition of income payments used here is the unrevised concept. See "National Income Supplement to Survey of Current Business," July 1947. The current level of income payments is higher than the $166 billion level assumed when these estimates were prepared. The higher level of income payments would raise the amounts of the revenue losses involved, but the percentages of the revenue losses to the total tax liability would not be changed appreciably.

2/ See Table 8 for estimated amounts of tax decrease under the two illustrative methods and Table 7 for the estimated total tax liability.

$100,000 to $250,000, and 3 percent for the income class $1 million and over. 1/ Accordingly, the bulk of the revenue loss from the earned income credit will tend to be allocated to taxpayers with incomes of less than $5,000 irrespective of the type of plan. Conversely, the overall incentive effects will tend to decrease as incomes increase, since a smaller proportion of the total income is affected.

Under either of the two illustrative methods of allowing an earned income credit, about 47.8 million income recipients would have their taxes reduced. Of these, about 46.2 million or 97 percent would be wage and salary earners with net income under $5,000. Under the 2-percent method about 4.5 million of these wage and salary earners would be made entirely nontaxable, and under the 10-percent method about 4.3 million would be made nontaxable. 2/

Approximately 88 percent of the tax reduction under the 2-percent method would go to the net income group below $5,000, while about 78 percent of the revenue loss would go to this group under the 10-percent method. While the revenue loss to the under $5,000 group is roughly the same under the two methods ($1,688 million under the 2-percent method and $1,622 million under the 10-percent method), the amount of revenue loss allocated to the income group with more than $5,000 of income is about twice as large under the 10-percent method ($470 million) as under the 2-percent plan ($237 million). Thus, the greater revenue loss under the 10-percent plan is entirely attributable to the larger tax savings which would be given to those with incomes above $5,000. However, while the revenue loss to those with incomes under $5,000 is between 17 and 18 percent of their total tax liability, the revenue loss as a percentage of total tax liability for those with incomes over $5,000 is 3 percent under the 2-percent method and 6 percent under the 10-percent method.

C. Modifications of illustrative earned income credits

1. Presumption that all income below a certain amount is earned

In earlier experience with the earned income credit in the United States, it was presumed that all income below a certain level

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1/ Table 7.
2/ Table 8.

with the size and nature of the business. Thus, a small farm with little mechanical equipment probably produces its income chiefly through the personal efforts of the proprietor. A farm with substantial amounts of capital in milking machines, tractors, and harvesters owes a greater part of its income to capital than to direct labor. Similarly, the income of a service business such as a research agency is more largely a function of personal effort than the income of, say, a motion picture theatre. It would be administratively impractical to make actual measurements of the earned portion of such business incomes and therefore some rather arbitrary presumption must be made. 1/ In the United States, 20 percent of the profits of partnerships and single proprietorships has been presumed to be earned. In foreign countries the interpretation has been broader, Great Britain, Canada, and Australia generally counting all business income as earned. 2/ A 20-percent presumption tends to understate the earned income portion of profits derived from small, labor-using business, while a 100-percent presumption tends to give an undue earned income credit advantage to large, capital-using business. In the past, the presumption that the first \$3,000 or \$5,000 of business income was earned, tended to give a practical solution to the equity aspects of this problem because of its sliding-scale effect when coupled with the 20-percent business income presumption. For example, under a \$5,000 presumption, 100 percent of the business income would be treated as earned up to \$5,000; between \$5,000 and \$10,000, the percentage treated as earned income would decrease from 100 percent to 50 percent; between \$10,000 and \$25,000, the percentage would decrease from 50 percent to 20 percent; and above \$25,000 of business income, the maximum percentage that could be claimed as earned income would be 20 percent. This type of presumption, if applied only to the business incomes of proprietors and partners actively employed in business, would not appear to be subject to the full force of the equity criticism discussed above in connection with a presumption that a minimum amount of income from any source be treated as earned.

The total amount of trade or business income of taxable income recipients is estimated to be \$19 billion, at the assumed level of \$166 billion of income payments. Thus, the tax effects between a low- and a high-percentage presumption can be expected to be relatively important. For example, under the 2-percent-tax-credit method, a 20-percent business income presumption would account for a revenue loss of less than \$75 million, while a 100-percent presumption would cost more than \$300 million.

1/ House Report No. 179, op. cit.

2/ Great Britain and Australia apply top limits to the amount of income which may be treated as earned, thereby curbing the tendency of this presumption to overstate the portion of profits attributable to wages of management for purposes of the credit.

VI. Appraisal of the earned income credit

In considering the incentive and equity arguments in favor of an earned income credit which have already been presented above, it should be clear that even the most objective appraisal must necessarily rely on opinion and judgment, since factual answers to all of the complex issues are unavailable and the responses of taxpayers to the equity and incentive aspects are divergent.

A. Equity aspects of the earned income credit

The arguments against an earned income credit either deny that the tax structure discriminates against earned income or contend that the credit is at best only a rough, and perhaps outmoded, approach toward achieving more equitable tax treatment for earned incomes. Thus, if earned incomes have special costs and expenses which ought to be allowed as deductions, then it is more equitable to allow them directly, since the credit would not differentiate between equal amounts of earned income with substantially different amounts of costs and expenses. Nor can it be said that all earned income involves greater psychic sacrifices than unearned income. Such a view overlooks both the psychic cost of saving often, if not always, involved in accumulating the capital producing the unearned income, and the unearned portions of the so-called earned income received by those individuals in positions or professions in which employment opportunities are limited by considerations other than capacity to do the work.

The depreciation argument is really motivated by the desire to help recipients of earned income to save an old-age fund. More adequate provision for old age might also be made through perfection of the social insurance system, rather than the reintroduction of an earned income credit. Moreover, high income earners who depend primarily on company or staff pension plans rather than social insurance already receive special treatment under the pension-plan provisions of the income tax.

As to equalizing the capital gains and the loss carry-over advantages accorded unearned income, it would be more equitable to introduce adequate averaging for all incomes, both earned and unearned. Averaging would solve the issue of variability of incomes and, in addition, might be helpful in setting to rest the ever-recurring problem of capital gains taxation. An earned income credit would not solve these vexatious problems.

Neither can the earned income credit be viewed as an effective offset to the tax-reducing, income-splitting opportunities available to recipients of unearned incomes. Here, too, there are more direct approaches, such as compulsory joint returns followed by the British income tax, or allowing all incomes to be split equally between spouses analogous to community-property treatment. 1/

Even if it is concluded that an individual's ability to pay the personal income tax is less when he receives earned as compared with unearned income, when all of the Federal, State and local taxes are considered, it is extremely difficult to say that earned incomes are treated less favorably than unearned incomes. On the one hand, local property taxes, the corporate income tax, and the estate and gift taxes are regarded as falling on unearned income and as providing substantial differentiation between earned and unearned incomes. Also, insofar as large incomes are in larger part unearned than earned the graduated surtax rates already impose a heavier burden on unearned incomes. On the other hand, the property taxes and corporate income taxes may in some measure be shifted, and the sales and excise taxes tend to weigh heavily on recipients of earned income. On balance, one cannot measure the extent of the discrimination, if any exists.

B. Incentive aspects of earned income credit 2/

1. High taxes and total effort

There is no question but that some income taxpayers respond to either a high level of tax or high rate of graduation by a reduction in effort. The questions unanswered are the extent of the reduction in physical effort, the effect on the psychological outlook towards hard work and the monetary reward for work, and the effect on the quantity and quality of the Nation's production. Finally, there is the question of the role that an earned income credit can be expected to play. These questions call for objective, quantitative answers. None is available. Resort must be made to what appear to be reasonable considerations for and against the general presumption that the individual income tax decreases the incentive of individuals to earn additional income.

1/ See "The Tax Treatment of Family Income," op. cit.

2/ For an interesting discussion of work-incentive effects of the Postwar I British Income tax, see Great Britain "Report of the Committee on National Debt and Taxation" (Colwyn Report), London, 1927, pp. 128-131, 158-164, and 379-381.

Two considerations support this presumption. On the one hand, there is the principle that additional units of income tend to have decreasing utility, whereas additional units of effort required to earn the additional income tend to have increasing disutility. Aside from the tax effects, individuals normally choose leisure over income when the disutility of additional effort is thought to be greater than the utility of the additional income likely to be earned. Under these conditions, a graduated income tax tends to lower the level of effort at which additional income is chosen over leisure, since graduation of tax rates leaves the individual with decreasingly smaller amounts of additional income after tax to compensate his additional effort. Consequently, an earned income credit of the 10-percent-deduction type should tend to increase the incentive to work, since it reduces the level of taxation and rate of graduation applicable to earned income.

Against these considerations which support the presumption that an earned income credit would increase incentives to work must be weighed other considerations which may more or less offset them. Since the impact of the income tax on the individual's incentive to work is in considerable part psychological, his acceptance of the fairness of the distribution of the tax burden and of the desirability of the purposes of the high taxes condition his willingness to work to an important extent. Thus, the wartime needs brought forth wartime effort. Most everyone worked harder in spite of ever-increasing taxes and other wartime restrictions with decentive effects. Postwar transitional needs, being more controversial, must be expected to provide a substantially smaller offset to the work-decentive effect of the income tax. However, for many taxpayers these transitional needs provide important if not entirely satisfactory reasons for high taxes and, consequently, their incentives to work may not be materially reduced. Other taxpayers may be substantially depressed by what they consider to be an unreasonably high or unfair tax burden, their unhappiness finding a partial outlet in a reduction of the quantity or quality of their effort.

Another offsetting consideration is based on the high demand for income by many individuals who desire to maintain relatively fixed or even increasing levels of consumption and saving. If taxes take larger proportions of their incomes, the incentives of these individuals to work tend to be increased rather than decreased. They will try, within the limits of their abilities, energies, and opportunities to earn more to attain and maintain the desired incomes after taxes.

A tax reduction would tend to reduce their incentives to work and slacken their efforts, since their objectives could be met with smaller incomes before tax. Actually, the decentive effects of high taxes on some taxpayers may provide otherwise unavailable opportunities for other taxpayers whose incentives to work have been stimulated. Thus, the opportunity for additional income turned down by an older, successful high-income professional or businessman who feels the added income after tax not worth his while, may be taken by a younger, aggressive substitute whose demand for additional income is high and who still has his mark to make. The work is done in spite of the high taxes, perhaps with less finesse, quality and smoothness in some cases. Others who do not find the needed opportunities in their current lines of work to earn more income to neutralize the tax (and other) effects on their standards of consumption and saving may move into other jobs or businesses where there are better chances of earning more. Others failing in their attempts to earn more may demand higher compensation for the same work and lower taxes. Finally, some taxpayers may resort to schemes of tax avoidance and evasion as a way out.

Even those whose incentives to work are decreased by taxes are limited in the extent to which they actually can reduce their efforts. Officials and proprietors of going concerns cannot turn down important clients, customers and income-producing opportunities because their competitors will not. Their positions and businesses must be protected from inroads likely to be made by their most aggressive competitors who are least affected by the high marginal tax rates. Moreover, hope springs eternal that future taxes will be lower and that the income-producing opportunities taken today will become more worth while. Similarly, the high-income-before-tax employee must protect his position against aggressive, potential competitors from within the business organization by meeting the work standards of the organization. These taxpayers may be unhappy, believing that the taxes are unreasonably high and leave them too little to show for their efforts, but they are not free to reduce their efforts accordingly.

In view of the foregoing considerations and in the absence of objective, quantitative information, there may be a real question as to whether the high rates of tax have in the short-run actually reduced the total effort materially even though on balance the incentives to work may have been reduced. Over a longer period of time, the momentum of the economic system may be slowed down by a persistent feeling that taxes are unreasonably high and unfairly distributed. This feeling, however, is not exclusively within the purview of high-income taxpayers. Now that prices are high and the cost of living rising, low-income taxpayers are demanding higher exemptions and lower rates so they may have more money after taxes to spend. But relatively moderate changes in these mass taxpayer areas have drastic effects on the revenues, while, as often pointed out, substantial rate reductions among upper income taxpayers involve relatively moderate revenue reductions under the individual income tax. 1/

Finally, even assuming that a tax reduction will on balance stimulate incentives to work and lead to greater output of effort, there is uncertainty respecting the superior effectiveness of an earned income credit compared with alternative methods of tax reduction.

2. The supply of executives

In this country, the current concern with the decentive effects of high income taxes on willingness to work is primarily directed towards the higher income earners, particularly in the business field. Executive capacity is undoubtedly a relatively scarce commodity. An earned income credit which significantly differentiates against unearned income would tend to draw a greater supply of executive effort into the tax-favored area away from the discriminated area. The results might be more noticeable in the long-run than in the short-run because new entrants drawn into the business executive field require experience and training not ordinarily obtainable elsewhere. The short-run supply might be increased, however, by the added inducement to existing executives to maintain and increase their efforts. The apparent short-run supply might also be increased by drawing from areas more or less closely related to the business executive field, such as investment counsel and promoters of business ventures. As already noted above, there must also be considered the offsetting effects arising from the fact that not all individuals respond to a given stimulus in the same way.

There is also a question whether an earned income credit would attract enough additional talent away from competing fields to make a substantial improvement in the quality and number of good business managers. First, remuneration is a major factor but only one of the determinants of occupational choices. Second, the net income of professionals (perhaps the greatest reservoir of needed business executive capacities) would ordinarily be classified as earned income and, consequently, professionals would be in the same favored position as business executives and would not need to change their occupations. However, many professions (such as law, accounting, and engineering) directly serve either as aids to business or as the fields of experience leading to executive positions, so that stimulating incentives in these areas may, in effect, be tantamount to increasing the supply of business effort. Moreover, a low presumption (such as 20 percent) respecting the earned income from trade or business of proprietors and partners may tend to induce individuals to hire themselves out as paid managers rather than

1/ See, for example, Table F and Chart A, Statement of the Secretary of the Treasury, Hearings before the Committee on Finance on H.R. 1, 80th Cong., 1st Sess., pp. 30 and 33.

continuing in or entering into the business field as entrepreneurs. This effect would not, of course, tend to increase the total supply of business executives. Also, the individuals whose work incentives are to be stimulated normally do not receive their incomes exclusively as earned income. Sooner or later, they all acquire property that yields unearned income. As the data show, a smaller and smaller proportion of taxpayers' incomes is earned as the size of their incomes increases. 1/ For these taxpayers, the incentive effects of an earned income credit may be materially weakened, since against the benefits of an earned income credit there must be offset the additional taxes on unearned income resulting from the differentiation in favor of earned income. The stimulus of an earned income credit is likely to be weakest in the case of the seasoned business manager who has climbed into the upper brackets of both earned and unearned income. It is likely to be strongest in the case of the executive who is working his way up and who has little income other than that which he earns. However, the work incentives of the former are most likely to be decreased by high taxes, whereas the demand for higher income and aggressiveness of the latter may more or less offset the decentive effects of high taxes.

Finally, insofar as executive positions and high-paying professional positions do require special talents and do yield high incomes even after taxes, the absence of differentiation in favor of earned incomes may not tend to decrease the long-run supply of persons capable of filling these positions. That is, even though the compensation after taxes is no longer as attractive as formerly under low taxes, the alternatives may be still less attractive. Thus, even though the net effect of a substantial earned income credit may be to increase the supply of effort on the part of existing executives, it does not necessarily follow that there will be a great improvement in the over-all supply of executive talent.

3. Work incentives and investment incentives

There appear to be no good grounds for regarding investment as performing a less useful part than personal service in the productive process. Many people believe that a healthy and prosperous economy depends on high levels of new investment. Insofar as an earned income credit differentiates against unearned income, there must also be considered the likelihood that incentives to invest are equally sensitive (or perhaps even more sensitive) to high taxes as incentives to work.

1/ Table 7.

It is extremely difficult to classify economic activities into those that merit special tax concessions and those that do not. It may be common to regard those who participate actively in economic affairs as deserving more favorable treatment than those who appear to be the passive beneficiaries of the economic system. Laborers, hired managers, small businessmen, promoters, explorers, and the like typify the active participants. The coupon clipper typifies the passive beneficiary. On close examination, however, the problem of economic classification is more difficult than at first appearance. For example, what is the fundamental distinction between the economic contribution of a hired manager and an active investor who directs his own capital now into one and then into another venture? This type of capitalist may be just as active and pioneering and just as great a genius at promotion and management as the hired manager himself. Most of his income would not be counted as earned. Incentive-wise, it is not reasonable to discriminate against him under the tax laws. It has been partly this inability to distinguish adequately between the earned and unearned portions of income jointly produced by effort and capital, typified by the proprietor or partner actively managing his own business venture, that in the past has led students of taxation to conclude that the earned income credit should be limited to moderate amounts of earnings. 1/

Moreover, as indicated above, none of the types discussed -- the hired business executive, the small or large capitalist directing his own investments, the promoter and the investment counsel directing other people's investments -- is normally the type receiving exclusively either earned or unearned income. Finally, not even against the coupon clipper is the case for discrimination clear. In a capitalistic economy, it is a function of private individuals to provide the needed capital. Capital derived from the riskiest common stock buys no more than the same amount derived from gilt-edge bonds. Neither do stocks necessarily involve more active management than bonds. Investors holding stocks may be just as passive as those holding bonds.

C. The earned income credit and alternative methods of reducing taxes

It is also important to inquire how the incentive aspects of an earned income credit compare with alternative ways of reducing taxes, such as personal exemption increases, allowing married couples to split their incomes 50-50, elimination of double taxation of dividends, and rate reductions.

1/ Colwyn Report, op. cit., p. 132.

An increase in personal exemptions would give the greatest relative amount of tax relief to the lower income groups without distinguishing between earned and unearned incomes. Indirectly, by increasing the demand of the mass of income taxpayers for goods and services, it would normally tend to stimulate work and investment incentives.

The chief beneficiaries of the proposal to split family incomes would be the married couples in the middle and upper brackets residing in noncommunity-property States who receive all or most of their income from earnings, but many high-income couples with unearned incomes in these States would also benefit in varying degrees depending on the extent to which their incomes are already split. 1/ Some incentive response could be expected from adoption of this proposal, because all of the revenue decrease would go to taxpayers whose incomes fall above the first surtax bracket.

Another alternative, reduction or elimination of double taxation of dividends, runs counter to the equity implications of an earned income credit, but not necessarily counter to the incentive aspects because business executives tend to have both earned and unearned incomes. If any of the proposals for the reduction or elimination of such double taxation were to be adopted, 2/ the scales would be tipped in favor of unearned as against earned income. In a sense there is a conflict of interest within business itself, the ownership group or stockholders gaining a relative advantage from adoption of any of the proposals that would relieve dividends and the hired managers of business gaining from adoption of an earned income credit. Adoption of both of these types of credits raises questions of discrimination and incentives to obtain income from other sources such as interest, rents and royalties, and the unearned portion of income received from proprietorships and partnerships. As substitutes for rate reductions, these credits also have the disadvantage of giving the rate structure a nominally high appearance which may have an undesirable psychological effect on incentives.

General rate reduction is still another alternative, especially in the higher income areas where the high marginal tax rates are more likely to affect the incentives to work and invest. The earned-income-credit method of stimulating work incentives has a distinct disadvantage as compared with tax rate reductions in that it must necessarily give a

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1/ "The Tax Treatment of Family Income," op. cit., p. 17.
2/ For an analysis of these proposals, see Treasury tax study "The Postwar Corporation Tax Structure," December 6, 1946.

greater portion of the tax reduction to low-income receivers, 1/ who probably need very little, if any, tax reduction to stimulate their incentives to work, both because their taxes are relatively low and because their needs for additional income are great. Moreover, the earned income credit tends to have a damping effect on investment because it differentiates against unearned income. However, as indicated above and as shown in Tables 5 and 6, substantial relief would be given to high, earned income recipients by a 10-percent earned income allowance, and it may have the advantage of tending to harmonize the incentive and equity issues.

Finally, if the Congress, as in the past, were to adopt an earned income credit with a presumption that the first $3,000 or $5,000 of income from any source be treated as earned and with a relatively low top limit above which earned income would be treated as unearned, the potential incentive effects would be greatly limited, the equity basis would be weakened, and the revenue cost would be materially increased by the minimum income presumption.

VII. Administrative aspects of earned income credit

The reintroduction of an earned income credit would add complications to the existing individual income tax procedures from both the viewpoints of taxpayer compliance and of administration by the Bureau of Internal Revenue.

A. Definition of earned income

It is difficult to formulate an administratively simple definition of earned income that is wholly satisfactory from the standpoints of equity and minimum revenue cost. While the wage and salary payments in the typical employee-employer arrangements are administratively satisfactory as a basis for determining an earned income credit, there are other important earned income areas where such arrangement are absent or inadequate. Thus, the actual separation of the earned and unearned portions of trade and business income is still administratively impractical. Consequently, this difficult problem, encompassing both equity and revenue issues, must, as in the past, be handled by means of statutory presumptions. 2/ If the presumption that a certain percentage of trade and business income

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1/ See Tables 8 and 9.
2/ See Section V, C, pp. 12-15, above.

is relatively low (say up to 20 percent), then a second presumption that a minimum amount of trade and business income is earned may be deemed desirable in the interest of equity. Such presumptions solve the practical problems but tend to raise the revenue cost. In practice, taxpayers tend to claim the maximum percentage of trade and business income as earned and the administrators tend to grant it.

In the past, the presumption that all income above a maximum amount was unearned placed a top limit on the tax value of the credit and reduced taxpayer incentive to overstate his earnings. Elimination of a top limit for the purpose of stimulating work incentives will also tend to stimulate some taxpayers to choose income in the form of higher salaries rather than profits or dividends, thus raising either the revenue cost of the credit or administrative questions as to the reasonableness of the salaries. 1/

Since over 80 percent of the taxpayers do not determine either an earned net income or a net income under present simplified procedures, it does not seem practical to reintroduce an earned income credit based, as in the past, on the lower of these two net incomes. Earned adjusted gross income would seem to be the simplest basis for determining a tax credit from both the viewpoints of ease of taxpayer compliance and administrative simplicity. 2/ This procedure has the disadvantage, however, of allowing some taxpayers with large earned incomes but small net incomes (owing to large allowable deductions) to pay little or no tax in some years. Since these cases would involve taxpayers who itemize their deductions and compute their net incomes, it might be feasible to limit an earned income credit to a specified percentage of the tax liability where the net income is less than a stipulated percentage of the earned adjusted gross income. Limitations of this type, however, tend to be cumbersome and add not only to the income tax complexities of the affected taxpayers but also to the administrative burden involved in checking the returns of taxpayers who should have voluntarily observed the limitation but didn't.

1/ Senate Report No. 398, op. cit., p. 23.
2/ See p. 9, above.

B. E[illegible]tax tables and tax forms

1. Tax tables

A presumption that the first $5,000 of income from any source is earned would permit the earned income credit to be incorporated into the Supplement T tax table. While this would produce the simplest procedure for both the mass of taxpayers using the tax table and the administrators, it would fail to differentiate in any way between earned and unearned incomes below this level and it would add substantially to the revenue cost of the credit. 1/

In the absence of such $5,000 presumption, the present procedures would be complicated for millions of taxpayers using the tax table on Form 1040 as well as the taxpayers using the long-Form 1040. Thus, under the two illustrative methods discussed above, 2/ taxpayers using the tax table would be required to follow the procedures described below compared with merely finding their tax liability in the tax table by reference to their adjusted gross incomes and number of exemptions.

Since wages subject to withholding would represent earned income, all withholding tables could be recomputed to reflect the earned income credit without change in the size or nature of the tables. The percentage method would have to be revised, however, and might become either somewhat less precise or more cumbersome.

2. Tax forms

Under the 2-percent-tax-credit method, 3/ the taxpayer using Form 1040 would first determine his tentative tax either from the tax table or by computation as under present procedures. Next he would determine his earned adjusted gross income and compute 2 percent of this amount. Finally, he would deduct the 2-percent credit from his tentative tax liability to find his final tax liability.

Under the 10-percent-deduction method, 3/ the taxpayer using Form 1040 would reduce his adjusted gross income by 10 percent of his earned adjusted gross income and then, on the basis of this smaller income, proceed to

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1/ See pp. 3, 12 and 13, above.
2/ See p. 9.
3/ Assuming no presumption that the first $5,000 of income, from whatever source derived, is earned.

find his tax in the tax table 1/ or by computation as [illegible] ent procedures.

To implement either of these methods for administrative purposes, Form 1040 and the instructions would need to be revised and expanded. In general, the schedules pertaining to annuities and pensions, profit (or loss) from business or profession, and income from partnerships would have to be revised to permit the segregation of the earned portions of such incomes. In addition, provision would need to be made for the aggregation of all earned income from the several possible sources, and for either the computation of the tax credit or the reduction of income, depending on the precise nature of the tax credit.

As already indicated, a presumption that the first $5,000 of income, from whatever source derived, is earned would permit the millions of taxpayers who use the tax table on Form 1040 to proceed directly to the tax table as under present procedures, since, for them, the tax credit could be incorporated into the tax table.

For the more than 20 million taxpayers using the Withholding Statement (Form W-2) as a final return, it would be desirable to introduce a small earned income presumption 2/ in the interest of simplicity and administrative convenience. Under present procedures, such taxpayers may include in the Form W-2 return (in addition to wages subject to withholding) not more than $100 of income from dividends, interest, and wages not subject to withholding. If it were presumed that all of such income is earned, a small amount of interest and dividends would be treated as earned. The maximum tax value of this presumption would be about $2, under present tax rates, in the extreme case that the entire $100 is derived from interest and dividends. This $100 presumption would permit the continuance of the present simplified procedures for both the taxpayers and the collectors of internal revenue. In the

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1/ It should be noted that a taxpayer using the tax table under this method would obtain a standard deduction of about 10% of the smaller income rather than 10% of the larger adjusted gross income as under present procedures. If this were considered inequitable treatment relative to taxpayers not using the tax table but claiming the $500 standard deduction, an adjustment could be made by allowing those using the tax table to deduct about 11% of their earned adjusted gross income.

2/ Assuming no presumption that the first $5,000 of income, from whatever source derived, is earned. Such a general presumption would also permit the continuance of the present simplified procedures for these taxpayers.

absence of this presumption, there is a question whether taxpayers with any income other than wages subject to withholding could be accommodated on this simplified return form because of the extreme limitation of space available to make the required distinction between earned and unearned income and of the additional administrative cost of making separate computations where unearned income appears compared with finding the tax in the tax table.

Treasury Department, Division of Tax Research November 1947

Table 1

Maximum tax saving resulting from the earned income credit and difference in tax on unearned and earned income computed at the level where maximum earned income credit applies, 1924-1943 1/

Married person - No dependents

Income year	Net income level at which maximum earned income credit applies	Portion of net income presumed to be earned, whether earned or not	Maximum earned income credit 2/	Tax liability computed for net income level at which maximum earned income credit applies, assuming		Difference in tax		
				All income is unearned	All income is earned	Amount	As a percentage of tax on unearned income	As a percentage of unearned income after tax
1924	$10,000	$5,000	$ 55	$ 208	$ 165	$ 43	20.7%	.4%
1925-27	20,000	5,000	206	819	619	200	24.4	1.0
1928-31 3/	30,000	5,000	496	1,979	1,489	490	24.8	1.7
1934-39	14,000	3,000	56	853	809	44	5.2	.3
1943	14,000	3,000	84	4,146 4/	4,080 4/	66	1.6	.7

Treasury Department, Division of Tax Research

1/ There was no provision for earned income credit for years prior to 1924 and for 1932-1933, and after 1943.
2/ Difference in tax computed with and without earned income credit.
3/ Tax for 1929 was reduced by decreasing the normal tax rates one percentage point.
4/ Tax liability for 1943 is unadjusted for transition to current payment basis. Includes net Victory tax and assumes that only one spouse has income.

Table 2

Difference in tax on unearned and earned income under present law 1/ in the United Kingdom, Canada and Australia, computed at the level where maximum earned income credit applies

Married person - No dependents

	Net income level at which maximum earned income credit applies	Tax liability computed for net income level at which maximum earned income credit applies, assuming: All income is unearned	Tax liability computed for net income level at which maximum earned income credit applies, assuming: All income is earned	Difference in tax: Amount	Difference in tax: As a percentage of tax on unearned income	Difference in tax: As a percentage of unearned income after tax
United Kingdom 2/						
Assuming wife has no earned income	$ 6,000	$ 2,271	$ 1,821	$ 450	19.8%	12.1%
Assuming wife's earned income is that for which maximum allowance is given 3/	6,000	2,271	1,623	648	28.5	17.4
Canada 4/	(30,000) 5/	12,443	11,315	1,128	9.1	6.4
Australia 6/	16,200 7/	8,992	8,178	814	9.1	11.3

Treasury Department, Division of Tax Research

Footnotes on next page.

Table 2 - concluded

Difference in tax on unearned and earned income under present law 1/ in the United Kingdom, Canada and Australia, computed at the level where maximum earned income credit applies

Footnotes:

1/ British Finance (No. 2) Act, 1945 and Finance Acts, 1946 and 1947, applicable to the year 1947-48; Canadian Income War Tax Act, as amended by Chapter 63, Statutes of 1947, applicable to 1948 and subsequent years; memorandum "Australian Income Taxation," J. U. Garside, Australian Government Trade Commissioner, November 28, 1945, and Australian Income Tax Act (No. 31) of 1946, applicable to the year 1946-47.

2/ Pound converted at $4.00

3/ Maximum working wife's allowance is $440, which corresponds to wife's income of $528 or more.

4/ Assuming wife's income from any source not in excess of $250. If wife's income is above $250 but not above $750, the married person's exemption of $1,500 is reduced by the amount of wife's income in excess of $250. If wife's income exceeds $750, she must file separately as a single person.

5/ There is no income level at which the differential in favor of earned income is a maximum. The amount of $30,000 is used in these computations because it is the maximum amount generally assumed to be earned in computations of tax burdens prepared by the Canadian government. No differentiation between earned and unearned income is made for the first $1,800 of income.

6/ Pound converted at $3.24.

7/ No differentiation between earned and unearned income is made for the first $648 of income.

Table 3

Comparison of tax value of earned income credit in the United Kingdom for 1947-48, Canada for 1948, and Australia for 1946-47, for selected amounts of net income

Married person 1/ - No dependents

Net income before personal exemption	Tax on unearned income			Difference between tax on earned and tax on unearned income			Difference in tax as a percentage of					
							Tax on unearned income			Unearned income after tax		
	United Kingdom	Canada	Australia	United Kingdom	Canada	Australia	United Kingdom	Canada	Australia	United Kingdom	Canada	Australia
$ 2,000	$ 471	$ 78	$ 344	$150	$ 8	$102	31.8%	10.3%	29.7%	9.8%	.4%	6.2%
5,000	1,821	798	1,570	375	128	355	20.6	16.0	22.6	11.8	3.0	10.3
10,000	4,271	2,318	4,684	450	328	740	10.5	14.2	15.8	7.9	4.3	13.9
15,000	7,296	4,368	8,129	450	528	811	6.2	12.1	10.0	5.8	5.0	11.8
25,000	14,296	9,568	15,372	450	928	814	3.1	9.7	5.3	4.2	6.0	8.5

Treasury Department, Division of Tax Research

1/ Assumes one spouse has all the income.

Note: Computations are based on rounded figures.

Sources: For the United Kingdom, British Finance (No. 2) Act, 1945, and Finance Acts, 1946 and 1947; for Canada, Income War Tax Act, as amended by Chapter 63, Statutes of 1947; for Australia, Income Tax Act (No. 31) of 1946.

Table 4

Comparison of successive increments of adjusted gross income before tax and after tax under present law, 1/ and under two illustrations of an earned income credit, for specified amounts of adjusted gross income

Married person 2/ - No dependents

Adjusted gross income 3/	Tax	Adjusted gross income after tax (1)-(2)	Successive increments of: Adjusted gross income	Successive increments of: Tax	Successive increments of: Adjusted gross income after tax (4)-(5)	Ratios: Increment of tax to increment of income (5)÷(4)	Ratios: Increment of income after tax to increment of income (6)÷(4)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
			Present law				
$ 1,000	-	$ 1,000					
1,500	$ 67	1,434	$ 500	$ 67	$ 434	13.3%	86.7%
2,000	152	1,848	500	86	415	17.1	82.9
3,000	323	2,677	1,000	171	829	17.1	82.9
5,000	694	4,307	2,000	371	1,630	18.5	81.5
10,000	1,862	8,138	5,000	1,169	3,832	23.4	76.6
15,000	3,434	11,566	5,000	1,572	3,428	31.4	68.6
25,000	7,695	17,305	10,000	4,261	5,739	42.6	57.4
35,000	12,854	22,147	10,000	5,159	4,842	51.6	48.4
50,000	21,375	28,625	15,000	8,522	6,479	56.8	43.2
75,000	37,421	37,580	25,000	16,046	8,955	64.2	35.8
100,000	54,891	45,109	25,000	17,471	7,530	69.9	30.1
150,000	92,701	57,299	50,000	37,810	12,190	75.6	24.4
200,000	131,024	68,976	50,000	38,323	11,677	76.6	23.4
			Tax credit of 2 percent of earned adjusted gross income 4/				
$ 1,000	-	$ 1,000					
1,500	$ 37	1,464	$ 500	$ 37	$ 464	7.3%	92.7%
2,000	112	1,888	500	76	425	15.1	84.9
3,000	263	2,737	1,000	151	849	15.1	84.9
5,000	594	4,407	2,000	331	1,670	16.5	83.5
10,000	1,662	8,338	5,000	1,069	3,932	21.4	78.6
15,000	3,134	11,866	5,000	1,472	3,528	29.4	70.6
25,000	7,195	17,805	10,000	4,061	5,939	40.6	59.4
35,000	12,154	22,847	10,000	4,959	5,042	49.6	50.4
50,000	20,375	29,625	15,000	8,222	6,779	54.8	45.2
75,000	35,921	39,080	25,000	15,546	9,455	62.2	37.8
100,000	52,891	47,109	25,000	16,971	8,030	67.9	32.1
150,000	89,701	60,299	50,000	36,810	13,190	73.6	26.4
200,000	127,024	72,976	50,000	37,323	12,677	74.6	25.4

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Footnotes on next page.

Table 4 - concluded

Comparison of successive increments of adjusted gross income before tax and after tax under present law, 1/ and under two illustrations of an earned income credit, for specified amounts of adjusted gross income

Married person 2/ - No dependents

Adjusted gross income 3/	Tax	Adjusted gross income after tax (1)-(2)	Successive increments of: Adjusted gross income	Successive increments of: Tax	Successive increments of: Adjusted gross income after tax (4)-(5)	Ratio: Increment of tax to increment of income (5)÷(4)	Ratio: Increment of income after tax to increment of income (6)÷(4)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Deduction of 10 percent of earned adjusted gross income from income 4/							
$ 1,000	-	$ 1,000					
1,500	$ 41	1,459	$ 500	$ 41	$ 459	8.2%	91.8%
2,000	118	1,882	500	77	423	15.4	84.6
3,000	272	2,728	1,000	154	846	15.4	84.6
5,000	599	4,401	2,000	328	1,672	16.4	83.6
10,000	1,606	8,395	5,000	1,006	3,994	20.1	79.9
15,000	2,923	12,077	5,000	1,318	3,682	26.4	73.6
25,000	6,519	18,481	10,000	3,596	6,404	36.0	64.0
35,000	10,998	24,002	10,000	4,479	5,521	44.8	55.2
50,000	18,425	31,575	15,000	7,427	7,573	49.5	50.5
75,000	32,426	42,574	25,000	14,001	10,999	56.0	44.0
100,000	47,709	52,291	25,000	15,283	9,717	61.1	38.9
150,000	81,287	68,713	50,000	33,578	16,422	67.2	32.8
200,000	115,634	84,366	50,000	34,347	15,653	68.7	31.3

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1/ Internal Revenue Code, as amended by the Revenue Act of 1945.
2/ Assumes one spouse has all the income.
3/ In computing tax under present law and under first illustration of an earned income credit, net income is taken as nine-tenths of adjusted gross income at all income levels. For tax under second illustration, net income is assumed to be nine-tenths of adjusted gross income after deduction of 10-percent earned income allowance.
4/ Assumes all adjusted gross income is earned and present law rates and exemptions apply. If all income is unearned, figures are same as under present law, provided earned income credit contains no presumption.

Note: Computations were made from unrounded figures and will not necessarily agree with figures computed from the rounded amounts and percentages shown.

Table 5

Comparison of tax liability under present law 1/ with tax under two illustrations of an earned income credit, for specified amounts of adjusted gross income

Married person 2/ - No dependents

Adjusted gross income 3/	Present law tax	Tax after allowing for earned income credit assuming all adjusted gross income is earned 4/	Decrease in tax: Amount	Decrease in tax: As a percentage of present law tax	Decrease in tax: As a percentage of adjusted gross income after present law tax
(1)	(2)	(3)	(4)	(5)	(6)
Tax credit of 2 percent of earned adjusted gross income					
$ 1,000	-	-	-	-	-
1,500	$ 67	$ 37	$ 30	45.1%	2.1%
2,000	152	112	40	26.3	2.2
3,000	323	263	60	18.6	2.2
5,000	694	594	100	14.4	2.3
10,000	1,862	1,662	200	10.7	2.5
15,000	3,434	3,134	300	8.7	2.6
25,000	7,695	7,195	500	6.5	2.9
35,000	12,854	12,154	700	5.4	3.2
50,000	21,375	20,375	1,000	4.7	3.5
75,000	37,421	35,921	1,500	4.0	4.0
100,000	54,891	52,891	2,000	3.6	4.4
150,000	92,701	89,701	3,000	3.2	5.2
200,000	131,024	127,024	4,000	3.1	5.8
Deduction of 10 percent of earned adjusted income from income					
$ 1,000	-	-	-	-	-
1,500	$ 67	$ 41	$ 26	38.6%	1.8%
2,000	152	118	34	22.5	1.9
3,000	323	272	51	15.9	1.9
5,000	694	599	94	13.6	2.2
10,000	1,862	1,606	257	13.8	3.2
15,000	3,434	2,923	511	14.9	4.4
25,000	7,695	6,519	1,176	15.3	6.8
35,000	12,854	10,998	1,855	14.4	8.4
50,000	21,375	18,425	2,950	13.8	10.3
75,000	37,421	32,426	4,995	13.3	13.3
100,000	54,891	47,709	7,182	13.1	15.9
150,000	92,701	81,287	11,414	12.3	19.9
200,000	131,024	115,634	15,390	11.7	22.3

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Footnotes on next page.

Table 5 - concluded

Comparison of tax liability under present law 1/ with tax under two illustrations of an earned income credit, for specified amounts of adjusted gross income

Married person 2/ - No dependents

Footnotes

1/ Internal Revenue Code, as amended by Revenue Act of 1945.
2/ Assumes one spouse has all the income.
3/ In computing tax under present law and under first illustration of an earned income credit, net income is taken as nine-tenths of adjusted gross income at all income levels. For tax under second illustration, net income is assumed to be nine-tenths of adjusted gross income after deduction of 10-percent earned income allowance.
4/ Assumes present law rates and exemptions. If all adjusted gross income is unearned, tax is same as under present law, provided earned income credit contains no presumption.

Note: Computations were made from unrounded figures and will not necessarily agree with figures computed from the rounded amounts and percentages shown.

Table 6

Comparison of two illustrations of an earned income credit with present law, 1/ for specified amounts of adjusted gross income

Married person 2/ - No dependents

Adjusted gross income 3/	Present law tax	Decrease in present law tax under earned income credit		Increase or decrease (-) of 10-percent plan over 2-percent plan	
		Allow tax credit of 2 percent of earned adjusted gross income 4/	Allow deduction of 10 percent of earned adjusted gross income 4/	Amount (4)-(3) 4/	As percentage of present law tax 5/ (5)÷(2) 4/
(1)	(2)	(3)	(4)	(5)	(6)
$ 1,000	-	-	-	-	-
1,100	-	-	-	-	-
1,200	$ 15	$ 15 5/	$ 15 5/	-	-
1,235 6/	21	21 5/	21	-	-
1,250	24	24 5/	21	$ -2	- 10.0%
1,258 7/	25	25	22	-4	- 14.4
1,300	32	26	22	-4	-11.7
1,400	49	28	24	-4	- 8.2
1,500	67	30	26	-4	- 6.5
2,000	152	40	34	-6	- 3.8
3,000	323	60	51	-9	- 2.7
4,000	505	80	75	-5	- .9
5,000	694	100	94	-6	- .9
5,800 8/	852	116	117	1	.2
8,000	1,349	160	185	25	1.9
10,000	1,862	200	257	57	3.0
15,000	3,434	300	511	211	6.1
25,000	7,695	500	1,176	676	8.8
35,000	12,854	700	1,855	1,155	9.0
50,000	21,375	1,000	2,950	1,950	9.1
75,000	37,421	1,500	4,995	3,495	9.3
100,000	54,891	2,000	7,182	5,182	9.4
150,000	92,701	3,000	11,414	8,414	9.1
200,000	131,024	4,000	15,390	11,390	8.7

Treasury Department, Division of Tax Research

Footnotes on next page.

Table 6 - concluded

Comparison of two illustrations of an earned income credit with present law, 1/ for specified amounts of adjusted gross income

Married person 2/ - No dependents

Footnotes

1/ Internal Revenue Code, as amended by the Revenue Act of 1945.
2/ Assumes one spouse has all the income.
3/ In computing tax under present law and under first illustration of an earned income credit, net income is taken as nine-tenths of adjusted gross income for all income levels. For tax under second illustration, net income is assumed to be nine-tenths of adjusted gross income after deduction of 10-percent earned income allowance.
4/ Assumes all adjusted gross income is earned and present law rates and exemptions apply. If all income is unearned, tax is same as under present law and figures in these columns are all zero, provided earned income credit contains no presumption.
5/ Taxpayer at this level of income would be made nontaxable under the earned income credit and part of the credit would be wasted.
6/ The exact breaking point where the earned income credit under the 10-percent plan would be just sufficient to eliminate present law tax is $1,234.57 of adjusted gross income before credit.
7/ The exact breaking point where the earned income credit under the 2-percent plan would be just sufficient to eliminate present law tax is $1,258.28 of adjusted gross income. At this level the 2-percent credit exceeds the value of the 10-percent credit by the maximum percentage, 14.5 percent, of present law tax.
8/ The exact breaking point where difference between the two earned income credits is zero is $5,755.83 of adjusted gross income before earned income allowance. For this amount, each plan results in a tax reduction of $115.12 from present law, assuming all adjusted gross income is earned.

Note: Computations were made from unrounded figures and will not necessarily agree with figures computed from the rounded amounts and percentages shown.

Table 7

Estimated number of taxable income recipients under present law, 1/ their adjusted gross income and total tax liability, and the number of taxable income recipients with earned adjusted gross income and their earned adjusted gross income, 2/ distributed by net income classes, assuming income payments 3/ of $166 billion

(Number of income recipients in thousands; money amounts in millions)

Net income classes (in thousands)	Number of taxable income recipients	Total adjusted gross income	Total tax liability 4/		Earned adjusted gross income		Ratio of earned adjusted gross income to total adjusted gross income
			Amount	Percent distribution	No. of taxable income recipients	Amount	
Under $1	6,352.3	$ 5,733.7	$ 299.5	1.8%	5,832.9	$4,196.5	73.2%
1 - 2	20,138.9	33,746.0	2,839.6	16.7	20,097.7	28,003.1	83.0
2 - 3	14,322.0	39,570.1	3,692.3	21.7	14,295.6	33,701.6	85.2
3 - 4	4,655.5	17,770.3	1,827.7	10.8	4,624.2	15,163.1	85.3
4 - 5	1,333.2	6,558.2	775.9	4.6	1,314.9	5,404.4	82.4
Under 5	46,801.8	103,378.3	9,435.0	55.5	46,165.3	86,468.6	83.6
5 - 10	1,126.9	8,421.9	1,318.0	7.8	1,071.5	5,460.5	64.8
10 - 25	470.2	7,546.6	1,874.4	11.0	426.6	3,666.5	48.6
25 - 50	101.2	3,733.9	1,435.5	8.4	91.2	1,447.0	38.8
50 - 100	32.7	2,389.7	1,183.6	7.0	29.3	776.2	32.5
100 - 250	9.8	1,548.7	915.2	5.4	8.7	374.2	24.2
250 - 500	1.3	497.4	328.9	1.9	1.2	78.6	15.8
500 - 1000	.4	335.1	234.5	1.4	.4	22.3	6.6
1000 and over	.2	387.7	276.2	1.6	.2	12.9	3.3
Over 5	1,742.8	24,861.0	7,566.3	44.5	1,629.1	11,838.2	47.6
Grand total	48,544.6	128,239.3	17,001.3	100.0	47,794.4	98,306.8	76.7

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Treasury Department, Division of Tax Research

Table 7 - concluded

Estimated number of taxable income recipients under present law, 1/ their adjusted gross income and total tax liability, and the number of taxable income recipients with earned adjusted gross income and their earned adjusted gross income, 2/ distributed by net income classes, assuming income payments 3/ of $166 billion

Footnotes

Note: Figures are rounded and will not necessarily add to totals.

1/ Internal Revenue Code, as amended by the Revenue Act of 1945.

2/ Earned income is defined as earned adjusted gross income from (a) all wages and salaries (including the income of self-employed professional individuals) and (b) up to 20 percent of trade or business income.

3/ Unrevised concept. See "National Income Supplement to Survey of Current Business," July 1947.

4/ Includes normal tax, surtax, and alternative tax on net long-term capital gains.

Source: Office of the Technical Staff, Treasury Department.

Table 8

Estimated number of taxable income recipients with reduced taxes or made nontaxable and the amount of tax decrease from present law, 1/ distributed by net income classes, under two methods of allowing earned income 2/ credits, assuming income payments 3/ of $166 billion

(Number of income recipients in thousands; money amounts in millions)

Net income classes (in thousands)	Number of taxable income recipients: With reduced taxes under the two methods of allowing earned income credits	Made nontaxable under method of allowing: 2% of earned adjusted gross income as a tax credit	Made nontaxable under method of allowing: 10% of earned adjusted gross income as a deduction from income	Tax decrease under method of allowing: 2% of earned adjusted gross income as a tax credit: Amount	2% ...: Percent distribution	10% of earned adjusted gross income as a deduction from income: Amount	10% ...: Percent distribution
Under $1	5,832.9	880.8	834.1	$ 79.7	4.1%	$ 75.7	3.6%
1 - 2	20,097.7	2,592.6	2,472.0	537.7	27.9	510.7	24.4
2 - 3	14,295.6	886.3	843.4	660.6	34.3	626.8	30.0
3 - 4	4,624.2	134.1	129.5	301.7	15.7	295.5	14.1
4 - 5	1,314.9	-	-	108.1	5.6	113.1	5.4
Under 5	46,165.3	4,493.8	4,279.0	1,687.8	87.7	1,621.8	77.5
5 - 10	1,071.5	-	-	109.2	5.7	135.4	6.5
10 - 25	426.6	-	-	73.3	3.8	149.6	7.2
25 - 50	91.2	-	-	28.9	1.5	86.8	4.2
50 - 100	29.3	-	-	15.5	.8	56.0	2.7
100 - 250	8.7	-	-	7.5	.4	32.0	1.5
250 - 500	1.2	-	-	1.6	.1	6.8	.3
500 - 1,000	.4	-	-	.4	*	1.9	.1
1,000 and over	.2	-	-	.3	*	1.1	.1
Over 5	1,629.1	-	-	236.7	12.3	469.6	22.5
Grand total	47,794.4	4,493.8	4,279.0	1,924.5	100.0	2,091.4	100.0

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Treasury Department, Division of Tax Research

Table 8 - concluded

Estimated number of taxable income recipients with reduced taxes or made nontaxable and the amount of tax decrease from present law, 1/ distributed by net income classes, under two methods of allowing earned income 2/ credits, assuming income payments 3/ of $166 billion

Footnotes

Note: Figures are rounded and will not necessarily add to totals.

1/ Internal Revenue Code, as amended by the Revenue Act of 1945.

2/ Earned income is defined as earned adjusted gross income from (a) all wages and salaries (including the income of self-employed professional individuals) and (b) up to 20 percent of trade or business income.

3/ Unrevised concept. See "National Income Supplement to Survey of Current Business," July 1947.

* Less than .05 percent.

Source: Office of the Technical Staff, Treasury Department.

Table 9

Estimated number of taxable income recipients with reduced taxes or made nontaxable and the amount of tax decrease from present law, 1/ distributed by net income classes, under two methods of allowing earned income credits modified by the presumption that the first $5,000 of any income is earned income, 2/ assuming income payments 3/ of $166 billion

(Number of income recipients in thousands; money amounts in millions)

Net income classes (in thousands)	Number of taxable income recipients: With reduced taxes under the two presumption methods of allowing earned income credits	Made nontaxable under presumption method of allowing: 2% of earned adjusted gross income as a tax credit	Made nontaxable under presumption method of allowing: 10% of earned adjusted gross income as a deduction from income	Tax decrease under presumption method of allowing 2% of earned adjusted gross income as a tax credit: Amount	2% of earned adjusted gross income as a tax credit: Percent distribution	10% of earned adjusted gross income as a deduction from income: Amount	10% of earned adjusted gross income as a deduction from income: Percent distribution
Under $1	6,305.1	959.2	908.4	$ 105.7	4.6%	$ 100.4	4.1%
1 - 2	20,119.6	2,597.9	2,477.1	646.7	28.3	614.4	25.0
2 - 3	14,313.4	888.0	845.0	774.8	33.9	735.2	30.0
3 - 4	4,650.3	135.0	303.3	353.0	15.5	345.7	14.1
4 - 5	1,330.0	-	-	130.7	5.7	136.7	5.6
Under 5	46,718.5	4,580.1	4,553.8	2,010.9	88.1	1,932.4	78.8
5 - 10	1,119.3	-	-	135.4	5.9	167.9	6.8
10 - 25	465.5	-	-	80.6	3.5	164.6	6.7
25 - 50	99.7	-	-	29.8	1.3	89.3	3.6
50 - 100	32.2	-	-	15.8	.7	57.1	2.3
100 - 250	9.6	-	-	7.6	.3	32.3	1.3
250 - 500	1.3	-	-	1.6	.1	6.8	.3
500 - 1,000	.4	-	-	.4	*	1.9	.1
1,000 and over	.2	-	-	.3	*	1.1	*
Over 5	1,728.2	-	-	271.5	11.9	521.0	21.2
Grand total	48,446.6	4,580.1	4,533.8	2,282.4	100.0	2,453.4	100.0

continued on next page

Treasury Department, Division of Tax Research

Table 9 - concluded

Estimated number of taxable income recipients with reduced taxes or made nontaxable and the amount of tax decrease from present law, 1/ distributed by net income classes, under two methods of allowing earned income credits modified by the presumption that the first $5,000 of any income is earned income, 2/ assuming income payments 3/ of $166 billion

Footnotes

Note: Figures are rounded and will not necessarily add to totals.

1/ Internal Revenue Code, as amended by the Revenue Act of 1945.

2/ Earned income is defined as earned adjusted gross income from (a) all wages and salaries (including the income of self-employed professional individuals) and (b) up to 20 percent of trade or business income, provided that the first $5,000 of adjusted gross income regardless of source shall be considered as earned adjusted gross income.

3/ Unrevised concept. See "National Income Supplement to Survey of Current Business," July 1947.

* Less than .05 percent.

Source: Office of the Technical Staff, Treasury Department.

TREASURY DEPARTMENT

Washington

FOR RELEASE, MORNING NEWSPAPERS,
Friday, November 14, 1947

Press Service
No. S-531

The Secretary of the Treasury, by this public notice, invites tenders for $1,100,000,000, or thereabouts, of 91-day Treasury bills, for cash and in exchange for Treasury bills maturing November 20, 1947, to be issued on a discount basis under competitive and non-competitive bidding as hereinafter provided. The bills of this series will be dated November 20, 1947, and will mature February 19, 1948, when the face amount will be payable without interest. They will be issued in bearer form only, and in denominations of $1,000, $5,000, $10,000, $100,000, $500,000, and $1,000,000 (maturity value).

Tenders will be received at Federal Reserve Banks and Branches up to the closing hour, two o'clock p.m., Eastern Standard time, Monday, November 17, 1947. Tenders will not be received at the Treasury Department, Washington. Each tender must be for an even multiple of $1,000, and in the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e. g., 99.925. Fractions may not be used. It is urged that tenders be made on the printed forms and forwarded in the special envelopes which will be supplied by Federal Reserve Banks or Branches on application therefor.

Tenders will be received without deposit from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. Tenders from others must be accompanied by payment of 2 percent of the face amount of Treasury bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

Immediately after the closing hour, tenders will be opened at the Federal Reserve Banks and Branches, following which public announcement will be made by the Secretary of the Treasury of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection thereof. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and his action in any such respect shall be final. Subject to these reservations, non-competitive tenders for $200,000 or less without stated price from any one bidder will be accepted in full at the average price (in three decimals) of accepted competitive bids. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank on November 20, 1947, in cash or other immediately available funds or in a like face amount of Treasury bills maturing

November 20, 1947. Cash and exchange tenders will receive equal treatment. Cash adjustments will be made for differences between the par value of maturing bills accepted in exchange and the issue price of the new bills.

The income derived from Treasury bills, whether interest or gain from the sale or other disposition of the bills, shall not have any exemption, as such, and loss from the sale or other disposition of Treasury bills shall not have any special treatment, as such, under the Internal Revenue Code, or laws amendatory or supplementary thereto. The bills shall be subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but shall be exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority. For purposes of taxation the amount of discount at which Treasury bills are originally sold by the United States shall be considered to be interest. Under Sections 42 and 117 (a) (1) of the Internal Revenue Code, as amended by Section 115 of the Revenue Act of 1941, the amount of discount at which bills issued hereunder are sold shall not be considered to accrue until such bills shall be sold, redeemed or otherwise disposed of, and such bills are excluded from consideration as capital assets. Accordingly, the owner of Treasury bills (other than life insurance companies) issued hereunder need include in his income tax return only the difference between the price paid for such bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made, as ordinary gain or loss.

Treasury Department Circular No. 418, as amended, and this notice, prescribe the terms of the Treasury bills and govern the conditions of their issue. Copies of the circular may be obtained from any Federal Reserve Bank or Branch.

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TREASURY DEPARTMENT
Washington

(The following address by Edward H. Foley, Jr., Assistant Secretary of the Treasury, before the National Convention of the Young Democratic Clubs of America at the Music Hall Auditorium, at Cleveland, Ohio, is scheduled for delivery at 1 p.m., E.S.T., Saturday, November 15, 1947, and is for release at that time.)

Most people in the United States think of the Treasury Department almost entirely in terms of money and bonds and taxes. It may surprise you when I say that upon becoming Assistant Secretary of the Treasury almost two years ago, I found that among my various responsibilities was supervising the work of one of the world's finest and largest law enforcement organizations.

The Treasury Department has been in the law enforcement business since 1789. At the present time, the Treasury enforcement agencies consist of six separate and distinct groups of officers engaged in the prevention, detection and suppression of crime. They are the Customs Service, the Coast Guard, the Bureau of Narcotics, the Alcohol Tax Unit and the Intelligence Unit of the Bureau of Internal Revenue, and the Secret Service. These units make up a coordinated enforcement army of 2,500 trained investigators, not including a total Coast Guard personnel of nearly 20,000 officers and men.

It is an interesting fact that those who would defraud their Government generally hold other laws in contempt. So, by enforcing the statutes over which we have jurisdiction, the Treasury agencies have put many a dangerous criminal behind bars. In fact, under peacetime conditions, our agents have regularly procured the evidence upon which more than half of all prisoners committed to Federal prisons have been convicted.

The question naturally arises in your minds as to why we have such an elaborate and well-trained crime detection service in the Treasury Department. It is an old saying that money is the root of all evil. Most crimes are committed, not from personal lust, but for money gain. The Treasury Department is charged with collecting all of Uncle Sam's revenue, with writing his checks, and with managing his debt and the entire money supply of the country. It is the business of the Treasury Law Enforcement agencies to detect frauds against the revenues, against checks, and against the money. These agencies protect Uncle Sam's pocketbook and in doing it, they protect your own too.

I should like first to tell you of the complex and interesting work performed by our six law enforcement agencies and then say something of what I conceive to be the importance of this work to our country.

All Americans who travel outside the borders of the United States have had an opportunity to observe the work of the Customs Service. The Service itself was created by the Fifth Act of the First Congress, approved by President Washington on July 31, 1789.

Smuggling is one of those things almost everyone thinks he could do if he tried. Like writing or acting, it looks easy and appears to pay well. The chances of detection seem slight. This sort of reasoning is attractive -- and deceptive. Actually, most "would be" smugglers are caught before they really get started. Between them and their dream fortunes stands an international army led by United States Customs officers, and including private detectives, under-cover operatives, informers, and such bodies as jewelers' protective agencies.

One of the most dramatic cases in recent months occurred at San Francisco. Many of you will remember reading in the press that an army Colonel failed to declare several large diamonds upon his arrival in the United States from Japan. An investigation of this matter by Customs agents led to the seizure of smuggled diamonds having a value of more than $200,000.

This discovery resulted in the Colonel's return to Japan under guard where he was court-martialed and sentenced to 15 years imprisonment. At the trial, a Japanese Government witness testified that he delivered nine thermos bottles of diamonds weighing 165 thousand karats to the Colonel. The market value of these diamonds was about $53,000,000.

Occasionally the Customs Service finds itself acting as an arm of our foreign policy. Recently Customs agents frustrated an attempt to export illegally from New Orleans landing craft, radios and other surplus army equipment which was to have been used in fomenting a revolution in a neighboring country.

Another law enforcement agency on my list is the Coast Guard. The Coast Guard has so many different law enforcement functions that it is difficult to catalog them all. It enforces all Federal laws on the high seas. These laws range from rules for the safety of seamen and passengers on merchant vessels to the protection of the Alaskan seal herd against poachers.

Just as the Fifth Act of the First Congress provided for the Customs Service, so the Ninth Act established the United States Lighthouse Service. The Lighthouse Service was one of the beginnings of the modern Coast Guard. Another was the Revenue Cutter Service which was conceived by Alexander Hamilton and established by Congress in 1790. Its functions as outlined by the relevant statute were to enforce the collection of customs duties and tonnage taxes, and it was also provided that its officers should also be "deemed officers of the Customs". So it is easy to see why the service logically belonged in the Treasury Department. There it was put and there it has remained ever since, except in time of war, when it serves with the Navy.

Another important law enforcement duty of the Treasury Department is that of safeguarding the integrity of our Government's obligations through the United States Secret Service, founded by President Lincoln in 1864.

One of the major functions of the Secret Service is the suppression of counterfeiting and the combatting of theft and forgery of Government checks and bonds. These crimes present a serious problem to the Treasury Department at the present time. Now, when the national income is averaging around $200,000,000,000 a year, when millions of citizens own Government bonds, and when a great volume of checks is sent every month by the Government to war veterans, pensioners, and creditors of the Government, it is more important than ever that all possible steps be taken to prevent taxpayers from suffering losses at the hands of thieves and forgers. The Secret Service received for investigation in the last fiscal year nearly 30,000 check cases and 12,000 bond cases. Over 70 percent of these difficult cases were solved.

Counterfeiting, too, is on the increase. In the first four months of this fiscal year, the Secret Service has seized over $2,250,000 in counterfeit American currency. Of this amount over $2,000,000 was seized before it could be put into circulation. Part of this sum was uncovered in France where two Secret Service agents in conjunction with the French police seized a complete counterfeiting plant and arrested eleven men near Marseilles.

The Secret Service is also charged with the protection of the President of the United States and all members of his family. It is likewise responsible for the safety of visiting dignitaries while they are in this country.

One of the most vicious of all criminals is the narcotics peddler, and it was to combat this dreadful social evil that the Bureau of Narcotics was formed. I am often asked why this seemingly unrelated service is in the Treasury Department. The chief reason is that the distribution of narcotics is controlled through the use of the taxing power. Narcotic agents wage a constant war against illicit trade in opium, morphine, cocaine, marihuana, and other habit-forming drugs.

While the Secret Service agent relies on shadowing to secure his information, and the intelligence agents of the Bureau of Internal Revenue delve into books and records in conducting their investigations, the narcotic agent often assumes the guise of an addict or a peddler and associates with under-world characters. Their work is fraught with danger, as the type of gangster found in narcotics rings will not hesitate to kill a Federal officer if some slip exposes his identity while engaged in an under-cover operation.

Recently a narcotic officer, operating under cover, was invited by a gang to go duck shooting. He excused himself gracefully from this expedition and later succinctly explained his reluctance by saying, "I felt I was singled out to be the duck".

One of the typical operations by agents against dope smugglers was conducted last summer and has become known in the annals of the Department as the "Affray at Woodbine Check". Woodbine Check is a drop in the All-American Irrigation Canal near Calexico, California, some 50 yards north of the international boundary line.

This affair was the culmination of a month long under-cover operation during which a narcotic agent worked his way into a gang of international opium smugglers by representing himself to be a big buyer of narcotics. He was equipped with a roll of bills made up to simulate 25 thousand dollars, and he was apparently so attractive to the sellers of narcotics that several competing brokers engaged in a contest for his business.

Finally on June 22 of this year, one of the gangs indicated it would deliver 138 cans of opium to him at Woodbine Check. The flat terrain at the spot made it impossible for fellow officers to take up advance positions and afford protection to the narcotic agent.

Since automobiles seldom visit the spot, only one car could be sent in or the gangsters would be suspicious. However, it was found possible to send two Customs officers to a building several hundred feet from the rendezvous, armed with rifles, and they afforded valuable support to the Treasury force in the fight that followed. It was also decided to conceal some men in the car to be used by the under-cover agent. The rear seat was removed and two Customs officers and one narcotic agent were concealed under suitcases and blankets.

The agent who had conducted the negotiations with the smugglers met three of them heavily armed on the bank of the canal.

On the pretense that his money was in the trunk of the car, the Treasury agent maneuvered the smugglers, one of whom had the opium in a sack, to the back of the car and signaled to the concealed officers.

They sprang out, the smugglers started shooting as they retreated, and the battle was on. Other smugglers who had been concealed on the canal bank beyond began firing with rifles. The battle continued for almost an hour and one smuggler and the sack of narcotics were captured. Treasury officers obtained positive evidence that at least two of the other gangsters died of their wounds after escaping into Mexican territory.

We turn now to the Bureau of Internal Revenue. This Bureau includes the Alcohol Tax Unit. The forerunners of the present Alcohol Tax Unit were the excise men. They began operations in 1791 to enforce a law which imposed taxes on distilled spirits. In putting down the so-called "whisky rebellion" in Western Pennsylvania, President Washington settled once and for all the question of the authority of the Federal Government to tax liquor.

In their work of preventing violations of the Internal Revenue laws relating to distilled spirits, wines, and malt liquors, the Alcohol Tax Unit agents use the most modern methods. They, like the other Treasury enforcement agencies, have two-way radio-equipped automobiles. The Coast Guard cooperates by furnishing aircraft for spotting liquor stills in wooded areas. The Alcohol Tax Unit taps many sources of information which enables them to locate illicit distilleries in our large cities, as well as in mountain canyons and southern swamps.

During the last fiscal year, the agents of the Alcohol Tax Unit seized over 6,000 stills and arrested almost 8,000 persons. The physical dangers which have cost the Alcohol Tax Unit over 200 lives in the past 30 years still exist.

But the most important job of the Bureau of Internal Revenue is collecting the income tax. The Intelligence Unit, organized in 1919, spearheads the drive against those who have sought to evade their share of the Federal taxes levied to support the functions of our Government.

The vast majority of our citizens are honest and scrupulous in their tax dealings with the Government. Yet, as a result of the high tax rates prevailing in recent years and the extraordinary war income levels in many lines and many geographical areas, the temptation to "keep it all" has proved to be too great for some individuals. A steady procession of cases into the Federal courts is demonstrating that cheating on Federal taxes does not pay.

During the almost three years that our concentrated post-war drive has been on, additional assessments of taxes and penalties, over and above the original tax involved, have totaled nearly $4,000,000,000.

This is truly a staggering sum.

A part of this total undoubtedly represents technical adjustments rather than evidence of outright evasion. Nevertheless, the greater part stems from our tax enforcement drive.

In addition, hundreds of millions of dollars have been paid voluntarily. We estimate that for every dollar expended in our tax enforcement effort, we have a return of more than $20.

Part of the success of our enforcement drive can be attributed to the splendid cooperation that we have had from banks and other money handling agencies in reporting the circumstances of all currency transactions of an unusual nature, either as to amount or as to denomination.

You may be interested in a specific case in which these reports have played a prominent part. Outstanding is one involving a prominent restaurant chain operator, now under a four-year prison sentence for tax evasion. The Treasury's investigation of the affairs of this company originated with bank reports of large currency deposits. We are now collecting several claims for additional taxes and penalties in this case in excess of $6,000,000.

We all have a stake in the efficient collection of every tax properly due the Government. As an aftermath of the war, we are faced with relatively heavy Government expenditures for some years to come, even after exercising the utmost economy. To the extent that one citizen or one business is able to evade its proper share of the tax burden to meet these expenditures, the deficiency must be made up by other taxpayers.

You may wonder what all of this has to do with you as Young Democrats. As articulate and influential citizens, your first concern is good Government. One of the foundations of good Government is honest and fearless law enforcement. President Truman and Secretary Snyder have always stood for vigorous and effective law enforcement with equal application to those in every walk of life.

In recent years we have become acutely aware of the menace that Communism offers to our American way of life and the peace of the world. Communism is the first, but not the only, evil that threatens the security of our Nation from within. Crime is another such evil, and crime in every form must be fought as vigorously as we know how. I can pledge you that the Treasury Department will continue to play its full part in this campaign.

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TREASURY DEPARTMENT

Washington

FOR IMMEDIATE RELEASE,
Monday, November 17, 1947

Press Service
No. S-533

During the month of October, 1947, market transactions in direct and guaranteed securities of the Government for Treasury investment and other accounts resulted in net sales of $14,128,500, Secretary Snyder announced today.

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TREASURY DEPARTMENT

Washington

FOR RELEASE, MORNING NEWSPAPERS
Tuesday, November 18, 1947.

Press Service
No. S-534

The Secretary of the Treasury announced last evening that the tenders for $1,100,000,000, or thereabouts, of 91-day Treasury bills to be dated November 20, 1947, and to mature February 19, 1948, which were offered November 14, 1947, were opened at the Federal Reserve Banks on November 17.

The details of this issue are as follows:

Total applied for - $1,538,029,000
Total accepted - 1,102,399,000 (includes $43,534,000 entered on a non-competitive basis and accepted in full at the average price shown below)

Average price - 99.765 Equiv. rate of discount approx. 0.931% per annum

Range of accepted competitive bids: (Excepting three tenders totaling $390,000)

High - 99.787 Equiv. rate of discount approx. 0.843% per annum
Low - 99.763 " " " " " 0.938% " "

(32 percent of the amount bid for at the low price was accepted)

Federal Reserve District	Total Applied for	Total Accepted
Boston	$ 3,165,000	$ 2,829,000
New York	1,401,375,000	1,003,959,000
Philadelphia	18,315,000	7,647,000
Cleveland	2,680,000	2,680,000
Richmond	6,025,000	6,025,000
Atlanta	3,230,000	3,230,000
Chicago	43,266,000	27,236,000
St. Louis	6,152,000	6,152,000
Minneapolis	3,395,000	3,395,000
Kansas City	12,438,000	12,338,000
Dallas	11,860,000	11,800,000
San Francisco	26,128,000	15,108,000
TOTAL	$1,538,029,000	$1,102,399,000

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TREASURY DEPARTMENT
Washington

FOR RELEASE, MORNING NEWSPAPERS,
Wednesday, November 19, 1947.

Press Service
No. S-535

Secretary of the Treasury Snyder today announced the offering, through the Federal Reserve Banks, of 1-1/8 percent Treasury Notes of Series A-1949, open on an exchange basis, in authorized denominations, to holders of 7/8 percent Treasury Certificates of Indebtedness of Series L-1947, maturing December 1, 1947, in the amount of $3,280,792,000, or 2 percent Treasury Bonds of 1947, maturing December 15, 1947, in the amount of $701,072,900. Exchanges will be made par for par in the case of the maturing certificates, and at par with an adjustment of interest as of December 15, 1947, in the case of the maturing bonds.

The notes now offered will be dated December 1, 1947, and will bear interest from that date at the rate of one and one-eighth percent per annum. As in the case of the notes offered by the Treasury last September, interest on the notes now offered will be paid with the principal at maturity on January 1, 1949. The notes will be issued in bearer form only, in denominations of $1,000, $5,000, $10,000, $100,000 and $1,000,000.

Pursuant to the provisions of the Public Debt Act of 1941, as amended, interest upon the notes now offered shall not have any exemption, as such, under the Internal Revenue Code, or laws amendatory or supplementary thereto. The full provisions relating to taxability are set forth in the official circular released today.

Subscriptions will be received at the Federal Reserve Banks and Branches, and at the Treasury Department, Washington, and should be accompanied by a like face amount of the securities to be exchanged and, where maturing bonds in coupon form are presented, by payment of accrued interest on the new notes at the rate of $0.43151 per $1,000, since in these cases interest is to be adjusted as of December 15, 1947. Subject to the usual reservations, all subscriptions will be allotted in full.

The subscription books will close for the receipt of all subscriptions at the close of business Friday, November 21.

Subscriptions addressed to a Federal Reserve Bank or Branch or to the Treasury Department, and placed in the mail before midnight November 21, will be considered as having been entered before the close of the subscription books.

The text of the official circular follows:

UNITED STATES OF AMERICA

1-1/8 PERCENT TREASURY NOTES OF SERIES A-1949

Dated and bearing interest from December 1, 1947 Due January 1, 1949

1947
Department Circular No. 819

Fiscal Service
Bureau of the Public Debt

TREASURY DEPARTMENT,
Office of the Secretary,
Washington, November 19, 1947.

I. OFFERING OF NOTES

1. The Secretary of the Treasury, pursuant to the authority of the Second Liberty Bond Act, as amended, invites subscriptions from the people of the United States for notes of the United States, designated 1-1/8 percent Treasury Notes of Series A-1949, in exchange for 7/8 percent Treasury Certificates of Indebtedness of Series L-1947, maturing December 1, 1947, or 2 percent Treasury Bonds of 1947, maturing December 15, 1947. Exchanges will be made par for par in the case of the maturing certificates, and at par with an adjustment of interest as of December 15, 1947, in the case of the maturing bonds.

II. DESCRIPTION OF NOTES

1. The notes will be dated December 1, 1947, and will bear interest from that date at the rate of 1-1/8 percent per annum, payable with the principal at maturity on January 1, 1949. They will not be subject to call for redemption prior to maturity.

2. The income derived from the notes shall be subject to all taxes, now or hereafter imposed under the Internal Revenue Code, or laws amendatory or supplementary thereto. The notes shall be subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but shall be exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority.

3. The notes will be acceptable to secure deposits of public moneys. They will not be acceptable in payment of taxes.

4. Bearer notes will be issued in denominations of $1,000, $5,000, $10,000, $100,000 and $1,000,000. The notes will not be issued in registered form.

5. The notes will be subject to the general regulations of the Treasury Department, now or hereafter prescribed, governing United States notes.

III. SUBSCRIPTION AND ALLOTMENT

1. Subscriptions will be received at the Federal Reserve Banks and Branches and at the Treasury Department, Washington. Banking institutions generally may submit subscriptions for account of customers, but only the Federal Reserve Banks and the Treasury Department are authorized to act as official agencies.

2. The Secretary of the Treasury reserves the right to reject any subscription, in whole or in part, to allot less than the amount of notes applied for, and to close the books as to any or all subscriptions at any time without notice; and any action he may take in these respects shall be final. Subject to these reservations, all subscriptions will be allotted in full. Allotment notices will be sent out promptly upon allotment.

IV. PAYMENT

1. Payment for notes allotted hereunder must be made on or before December 1, 1947, or on later allotment. Payment of the principal amount may be made only in Treasury Certificates of Indebtedness of Series L-1947, maturing December 1, 1947, or in Treasury Bonds of 1947, maturing December 15, 1947, which will be accepted at par and should accompany the subscription. The full year's interest on the certificates surrendered will be paid to the subscriber following acceptance of the certificates. In the case of the maturing bonds in coupon form, payment of accrued interest on the new notes from December 1, 1947 to December 15, 1947 ($0.43151 per $1,000) should be made when the subscription is tendered. In the case of maturing registered bonds, the accrued interest will be deducted from the amount of the check which will be issued in payment of final interest on the bonds surrendered. Final interest due December 15 on bonds surrendered will be paid, in the case of coupon bonds, by payment of December 15, 1947 coupons, which should be detached by holders before presentation of the bonds, and in the case of registered bonds, by checks drawn in accordance with the assignments on the bonds surrendered.

V. ASSIGNMENT OF REGISTERED BONDS

1. Treasury Bonds of 1947 in registered form tendered in payment for notes offered hereunder should be assigned by the registered payees or assignees thereof to "The Secretary of the Treasury for exchange for Treasury Notes of Series A-1949 to be delivered to ________", in accordance with the general regulations of the Treasury Department governing assignments for transfer or exchange, and thereafter should be presented and surrendered with the subscription to a Federal Reserve Bank or Branch or to the Treasury Department, Division of Loans and Currency, Washington, D. C. The bonds must be delivered at the expense and risk of the holder.

VI. GENERAL PROVISIONS

1. As fiscal agents of the United States, Federal Reserve Banks are authorized and requested to receive subscriptions, to make allotments on the basis and up to the amounts indicated by the Secretary of the Treasury to the Federal Reserve Banks of the respective Districts, to issue allotment notices, to receive payment for notes allotted, to make delivery of notes on full-paid subscriptions allotted, and they may issue interim receipts pending delivery of the definitive notes.

2. The Secretary of the Treasury may at any time, or from time to time, prescribe supplemental or amendatory rules and regulations governing the offering, which will be communicated promptly to the Federal Reserve Banks.

JOHN W. SNYDER,
Secretary of the Treasury.

TREASURY DEPARTMENT

Washington

(The following address by Secretary Snyder before the National Industrial Conference Board at the Waldorf-Astoria Hotel, New York City, is scheduled for delivery at 9:00 P.M., E.S.T., Thursday Evening, November 20, 1947, and is for release at that time.)

World War II proved conclusively that no single nation, nor any narrow group of nations, can be self-sufficient. Today, national policies and programs which do not give full recognition to this fact, cannot be sound in concept and effective in operation.

We in this country should realize now, as never before, that the United States, with all its resources, with all the practical and creative abilities of its people, cannot continue to grow and progress satisfactorily by itself. American economy to a great degree depends upon the economies of other countries. We could not long maintain our present high standards without international economic stability.

This meeting of your Conference Board takes place at a time when the people of the United States are approaching far-reaching decisions affecting the economic and financial future of the nation.

In making these determinations, we are duly aware of the heavy cost of government today. "Meeting the High Cost of Government" is a matter of grave moment to every individual American. But I believe that a discussion on this subject could more appropriately be termed "Meeting the High Cost of Civilization." For, in the face of present world developments, meeting the high cost of government is nothing less than defraying the cost of freedom and security and continued well-being.

I particularly welcome the opportunity to appear before you to discuss aspects of our financial and economic situation in its relation to present-day issues.

We are inextricably tied up with the fate of western Europe and other nations of the world. We could not escape the results that would follow world chaos. We know, particularly from our war experience, how interdependent nations are today. We witnessed wide restrictions to our own productive capacity when at the beginning of the last war, the United States was cut off from the supply of strategic and critical materials from other parts of the world. We have learned, too, both during and after the war, the imperative need other nations have for American goods.

War disrupted and destroyed many essential industrial areas of the world economy, leaving many nations looking to us for goods and tools and technical knowledge to repair the damages.

Although two years have passed since the war, the devastation wrought was of such enormity that dangerous resultant conditions are yet a long way from correction.

Weighing our responsibility and our ability to aid the re-establishment of world economies, we should, in light of our experience, make a careful inventory of those things which the world needs from us now as balanced against the products which we need from other nations.

In many fields, American industry would suffer materially if we could not obtain certain essential products or their constituent raw materials from abroad.

Crude rubber, copper, bauxite, lead, manganese, and zinc are examples of imports indispensable to us in the manufacture of a variety of products.

Certain strategic items, such as industrial diamonds, asbestos, cordage fibers, mica, graphite, quinine, and the like, are mainly produced outside our own country. Without them, our civilian and military needs would not be sufficiently met.

Coffee and sugar are important examples of imports which affect intimately the life of the average American.

On the other side of the picture, foreign nations are in vital need of American goods. Countries torn by war need supplies to replace capital goods destroyed and to provide foodstuffs which formerly they largely grew themselves. Even Latin-American countries, which like us did not suffer any physical devastation at home, have been unable during and since the war to obtain all essential materials.

The European situation is especially acute. Standards of living have been critically reduced over a large part of Europe, and the hard winter of last year did much to make the situation worse.

Food and fuel shortages are in evidence throughout Europe, particularly so in France, Austria and Italy.

Re-establishment of productive capacities has been much slower than expected.

Coal production, dependent mainly on England and Germany, has been drastically retarded, and imports from non-European areas have been required to meet the barest necessities.

Due to the inadequacy of foreign exchange, imports of other raw materials have also had to be curtailed. The examples are numerous and important. The lack of wool, cotton, and other fibers gives rise to the general shortage of textiles -- restricted steel availabilities to shortages of rolling stock, vehicles, and equipment in general -- less than normal imports of timber to the slowing down of repairs and new construction.

The speed and efficiency with which measures are taken to relieve these conditions will be strongly reflected in our future international trade relations.

European recovery, for example, would make an important contribution to restoring international trade to private channels. And, it would in turn go a long way towards releasing trade from the discriminatory government control which prevails in certain instances.

American business has suffered in times past from such practices in the allocation of quotas, in the determination of exchange rates, and in the more complex relationships of trade and exchange control. It has been one of the principal objectives of our foreign economic policy in the last 14 years to break down these barriers and to eliminate, as far as possible, world trade disadvantages to American business and American labor. European economic recovery is essential to this objective.

The European Recovery Program, which will shortly be under consideration by the Congress, is based upon cooperative effort of all participating countries and upon the United States making available to such countries certain necessary commodities and services which they cannot provide for themselves at this time.

The conditions under which this foreign aid will be offered are that the participating countries will make the most of their own resources and will make the most effective use of aid from the United States.

Both the interim aid program, which provides for urgently needed food and fuel during this coming winter, and the long range aid program, which provides for tangible recovery, are conceived with a full realization of the fact that our own resources are not inexhaustible.

For all practical purposes, and within our means, we are committed to taking an active part in the rehabilitation of the world because, it is well to repeat, we recognize the inter-dependency of nations, because we know that we cannot continue in our own prosperous state while the rest of the world remains in such an unsettled condition, and because we are determined, to the fullest possible extent, to bring about a stable world peace.

It would profit neither Europe nor the world if, in efforts to restore international stability, we should lose our own stability. For, although the United States is enjoying the greatest business activity in its history, and although we are making amazing records in production, in employment, in national income, and in business profits, we will be unable to continue to help ourselves, much less needy countries abroad, if we do not keep our own house in order. We must assure a financially strong government. We must maintain our national fiscal integrity.

It is unfortunate that a great many people today overlook this obligation. These people follow the line of least resistance by advocating tax reduction without regard to sound fiscal prudence.

As Secretary of the Treasury, I must consistently and forcibly advocate the policy of providing sufficient revenues to meet current obligations and to permit steady liquidation of the public debt.

The United States Treasury closed its last fiscal year with a surplus for the first time in 17 years. Certainly during this present period of prosperity, we should maintain a balanced budget with adequate provision for debt reduction.

It is a sobering thought that although our public debt has been materially reduced from its peak, it still remains at the staggering figure of $258,000,000,000.

The public debt of the United States is a contract between the government and the people of this country. Government bonds are held by individuals, by insurance companies, by banks, by educational and charitable foundations. We must not weaken public confidence in government obligations by ignoring our debt at a time when we should reduce it.

I want to make it perfectly clear that I am not opposed to tax reduction. I believe tax reduction feasible and proper after we have met certain necessary prerequisite obligations. I am convinced, however, that before deciding on tax reductions, the Congress should first consider foreign aid within a balanced budget, second, adequate debt reduction, and third, equitable tax revision. When these three necessary preliminary steps have been taken, consideration of equitable tax reduction would be in order.

The Treasury Department has placed before the appropriate Congressional committees a detailed study of various tax issues.

I should like to mention here certain of those fields in which the Treasury feels particular consideration is warranted in devising a sensible postwar tax structure.

Over the years, the rapid expansion of the nation demanded a comparable increase of governmental services, which in turn made it necessary to seek additional sources of tax revenue. Much of the existing tax system was enacted during critical periods of depression and war, and consequently, certain inequities have become imbedded in the tax structure.

For example, excise taxes should be revised, particularly those that bear substantially on business costs, or that tend to by pyramided, or are overly regressive in the process of shifting the tax on to consumers.

The corporate tax structure has a number of important areas for consideration in addition to matters of rates.

Careful thought should be given to the correction of the so-called double taxation of dividends.

Economic considerations must be given to problems of small business.

The role of Federal estate and gift taxes should be strengthened by better integration of the estate tax with the gift tax, and of both with the income tax.

Individual income tax should be revised to provide a method for treating family income on a uniform basis in all states.

Postwar tax revision should also strive to make some contribution to Federal-State tax coordination.

Substantial technical adjustments in the present law would go a long way toward smoothing the relationship between taxpayer and Government, providing equity, promoting simplicity for taxpayers, and easing administration for the Government.

But I would call to your attention that in making many of the needed tax adjustments to correct inequities, we will incur a substantial loss of revenue. Until such time as we determine the extent of this net loss, we should not be too hasty in using up our margin of surplus in a general tax reduction that might make impossible these vitally necessary adjustments.

The creation of a sound post-war tax system is a much more complex matter than the arbitrary revision of rates.

In closing, I would like to summarize the elements of a fiscal and tax policy calculated, in my belief, to have the maximum salutary effect upon our domestic economy at this stage, and upon the carrying out of our obligations to promote world peace and recovery.

We must maintain revenues at a level adequate to finance our interim relief and ultimate European Recovery Program commitments within the framework of a budget, not only balanced but with a surplus devoted to public debt reduction.

We must eliminate the inequities, inconsistencies, complexities, and unproductive elements of present-day tax laws.

We can thus maintain a sound, prudent, fiscal position.

When we talk of the high cost of Government, we must remember all these foregoing considerations.

But to arrive at the total cost of operating our Government, we must add the other expenditures of Government, namely: maintaining national defense to prevent World War III; provision for our veterans of all wars; paying interest on our present debt, which was largely created by

World War II; our present commitments for international finance which grew out of events of World War II;tax refunds; social security commitments; and the maintaining of all other departments of the Government.

The President earnestly endeavored to cut the budget last year. His work was so effective that the Congress found it impossible to reduce materially his submitted estimate of necessary Government expenditures.

Whether or not the expenditures of the Government can be greatly reduced this coming year in the face of present world conditions is a problem to which the President and his Administration have been and are giving careful consideration and study.

But regardless of the outcome of this study, we must face the cold fact that in this transition period, our costs of Government are necessarily going to be high.

It will take the cooperation and forbearance of all our people and all elements of our national life to meet the challenge of maintaining our obligations while striving always to reduce as rapidly as is prudent the total cost of operating our government.

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TREASURY DEPARTMENT

Washington

FOR RELEASE, MORNING NEWSPAPERS,
Friday, November 21, 1947.

Press Service
No. S-537

The Secretary of the Treasury, by this public notice, invites tenders for $1,200,000,000, or thereabouts, of 90-day Treasury bills, for cash and in exchange for Treasury bills maturing November 28, 1947, to be issued on a discount basis under competitive and non-competitive bidding as hereinafter provided. The bills of this series will be dated November 28, 1947, and will mature February 26, 1948, when the face amount will be payable without interest. They will be issued in bearer form only, and in denominations of $1,000, $5,000, $10,000, $100,000, $500,000, and $1,000,000 (maturity value).

Tenders will be received at Federal Reserve Banks and Branches up to the closing hour, two o'clock p.m., Eastern Standard time, Monday, November 24, 1947. Tenders will not be received at the Treasury Department, Washington. Each tender must be for an even multiple of $1,000, and in the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e. g., 99.925. Fractions may not be used. It is urged that tenders be made on the printed forms and forwarded in the special envelopes which will be supplied by Federal Reserve Banks or Branches on application therefor.

Tenders will be received without deposit from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. Tenders from others must be accompanied by payment of 2 percent of the face amount of Treasury bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

Immediately after the closing hour, tenders will be opened at the Federal Reserve Banks and Branches, following which public announcement will be made by the Secretary of the Treasury of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection thereof. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and his action in any such respect shall be final. Subject to these reservations, non-competitive tenders for $200,000 or less without stated price from any one bidder will be accepted in full at the average price (in three decimals) of accepted competitive bids. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank on November 28, 1947, in cash or other immediately available funds or in a like face amount of Treasury bills maturing

November 28, 1947. Cash and exchange tenders will receive equal treatment. Cash adjustments will be made for differences between the par value of maturing bills accepted in exchange and the issue price of the new bills.

The income derived from Treasury bills, whether interest or gain from the sale or other disposition of the bills, shall not have any exemption, as such, and loss from the sale or other disposition of Treasury bills shall not have any special treatment, as such, under the Internal Revenue Code, or laws amendatory or supplementary thereto. The bills shall be subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but shall be exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority. For purposes of taxation the amount of discount at which Treasury bills are originally sold by the United States shall be considered to be interest. Under Sections 42 and 117 (a) (1) of the Internal Revenue Code, as amended by Section 115 of the Revenue Act of 1941, the amount of discount at which bills issued hereunder are sold shall not be considered to accrue until such bills shall be sold, redeemed or otherwise disposed of, and such bills are excluded from consideration as capital assets. Accordingly, the owner of Treasury bills (other than life insurance companies) issued hereunder need include in his income tax return only the difference between the price paid for such bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made, as ordinary gain or loss.

Treasury Department Circular No. 418, as amended, and this notice, prescribe the terms of the Treasury bills and govern the conditions of their issue. Copies of the circular may be obtained from any Federal Reserve Bank or Branch.

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TREASURY DEPARTMENT
Washington

FOR RELEASE, MORNING NEWSPAPERS
Monday, November 24, 1947

Press Service
No. S-538

The total assets of national banks on October 6 of this year amounted to $86,000,000,000, it was announced today by Comptroller of the Currency Preston Delano. The returns from the call covered 5,019 active banks in the United States and possessions. The assets were $2,500,000,000 more than reported by the 5,018 active national banks on June 30, 1947, the date of the previous call, and were more than $300,000,000 over the amount reported by the 5,014 active banks as of September 30, 1946, the date of the corresponding call last year.

The deposits of national banks on October 6, 1947 were nearly $80,000,000,000, which was an increase of more than $2,000,000,000 since June 1947, but a decrease of $150,000,000 since September 1946. Included in the current deposit figures are demand deposits of individuals, partnerships, and corporations of $45,778,000,000, which increased $1,027,000,000, or 2 percent, in the three month period, and time deposits of individuals, partnerships, and corporations of $18,726,000,000, which increased $169,000,000, or 1 percent. Deposits of the United States Government of $1,617,000,000 were $749,000,000 more than in June; deposits of States and political subdivisions of $4,318,000,000 showed a decrease of $244,000,000, or more than 5 percent, and deposits of banks of $8,153,000,000 were $719,000,000, or nearly 10 percent, more than in June. Postal savings deposits were $2,800,000, and certified and cashiers' checks were $1,124,000,000.

Loans and discounts were $20,081,000,000 on October 6, which was an increase of $1,271,000,000, or nearly 7 percent, since June, and an increase of $4,280,000,000, or 27 percent, since September last year.

The banks held obligations of the United States Government of $39,622,000,000, an increase of $197,000,000, or one-half of one percent, since June, but a decrease of $5,693,000,000, or more than 12 percent, in the year. Obligations of States and political subdivisions held in October amounted to $3,050,000,000, an increase of $149,000,000 over the June figure, and other securities held were $2,137,000,000, an increase of $85,000,000.

Cash of $1,039,000,000, balances with other banks (including cash items in process of collection) of $7,922,000,000, and reserves with Federal Reserve banks of $11,256,000,000, a total of $20,217,000,000, increased $821,000,000 since June 30.

The unimpaired capital stock of the banks on October 6, 1947 was $1,775,000,000, including $27,000,000 of preferred stock. Surplus was $2,342,000,000, undivided pro its $964,000,000, and reserves $340,000,000. Total capital accounts of $5,421,000,000 were $112,000,000, or 2 percent, more than at the end of June, and $290,000,000, or nearly 6 percent, more than in September last year.

The percentage of loans and discounts to total deposits on October 6, 1947 was 25.19 percent, in comparison with 24.30 percent on June 30, 1947, and 19.78 percent on September 30, 1946.

Statement showing comparison of principal items of assets and liabilities of active national banks as of October 6, 1947, June 30, 1947, and September 30, 1946

(In thousands of dollars)

	Oct. 6, 1947	June 30, 1947	Sept. 30, 1946	Increase or decrease since June 30, 1947		Increase or decrease since Sept. 30, 1946	
				Amount	Percent	Amount	Percent
Number of banks	5,019	5,018	5,014	1	.02	5	.10
ASSETS							
Loans on real estate } Other loans, including overdrafts }	$20,081,046	($4,228,135) (14,581,871)	$15,801,498	$1,271,040	6.76	$4,279,548	27.08
Total loans	20,081,046	18,810,006	15,801,498	1,271,040	6.76	4,279,548	27.08
U. S. Government securities:							
Direct obligations } Obligations fully guaranteed }	39,622,267	(39,419,227) (6,378)	45,315,509	196,662	.50	-5,693,242	-12.56
Total U. S. securities	39,622,267	39,425,605	45,315,509	196,662	.50	-5,693,242	-12.56
Obligations of States and political subdivisions	3,050,027	2,900,981	2,670,103	149,046	5.14	379,924	14.23
Other bonds, notes, and debentures	1,981,623	1,896,733	1,971,204	84,890	4.48	10,419	.53
Corporate stocks, including stocks of Federal Reserve banks	155,952	155,338	153,448	614	.40	2,504	1.63
Total securities	44,809,869	44,378,657	50,110,264	431,212	.97	-5,300,395	-10.58
Total loans and securities	64,890,915	63,188,663	65,911,762	1,702,252	2.69	-1,020,847	-1.55
Currency and coin	1,038,572	988,288	957,986	50,284	5.09	80,586	8.41
Reserve with Federal Reserve Banks	11,256,403	10,623,726	10,496,652	632,677	5.96	759,751	7.24
Balances with other banks	7,921,634	7,783,534	7,455,805	138,100	1.77	465,829	6.25
Total cash, balances with other banks, including reserve balances and cash items in process of collection	20,216,609	19,395,548	18,910,443	821,061	4.23	1,306,166	6.91
Other assets	879,852	829,049	835,606	50,803	6.13	44,246	5.30
Total assets	85,987,376	83,413,260	85,657,811	2,574,116	3.09	329,565	.38

Comparison of principal items of assets and liabilities of national banks - continued
(In thousands of dollars)

	Oct. 6, 1947	June 30, 1947	Sept. 30, 1946	Increase or decrease since June 30, 1947: Amount	Increase or decrease since June 30, 1947: Percent	Increase or decrease since Sept. 30, 1946: Amount	Increase or decrease since Sept. 30, 1946: Percent
LIABILITIES							
Deposits of individuals, partnerships and corporations:							
Demand	$45,778,324	$44,751,010	$44,320,244	$1,027,314	2.30	$1,458,080	3.29
Time	18,725,697	18,556,606	17,718,574	169,091	.91	1,007,123	5.68
Postal savings deposits	2,793	2,804	2,787	-11	-.39	6	.22
Deposits of U. S. Government	1,617,480	868,049	5,073,626	749,431	86.34	-3,456,146	-68.12
Deposits of States and political subdivisions	4,318,484	4,562,716	3,939,025	-244,232	-5.35	379,459	9.63
Deposits of banks	8,153,144	7,433,963	7,712,905	719,181	9.67	440,239	5.71
Other deposits (certified and cashiers' checks, etc.)	1,124,122	1,222,001	1,102,473	-97,879	-8.01	21,649	1.96
Total deposits	79,720,044	77,397,149	79,869,634	2,322,895	3.00	-149,590	-.19
Bills payable, rediscounts, and other liabilities for borrowed money	143,835	27,860	45,227	115,975	416.28	98,608	218.03
Other liabilities	702,465	679,571	611,622	22,894	3.37	90,843	14.85
Total liabilities, excluding capital accounts	80,566,344	78,104,580	80,526,483	2,461,764	3.15	39,861	.05
CAPITAL ACCOUNTS							
Capital stock:							
Preferred stock	27,010	28,359	44,612	-1,349	-4.76	-17,602	-39.46
Common stock	1,748,453	1,742,512	1,703,976	5,941	.34	44,477	2.61
Total	1,775,463	1,770,871	1,748,588	4,592	.26	26,875	1.54
Surplus	2,341,737	2,329,951	2,176,630	11,786	.51	165,107	7.59
Undivided profits	963,589	874,798	883,238	88,791	10.15	80,351	9.10
Reserves	340,243	333,060	322,872	7,183	2.16	17,371	5.38
Total surplus, profits and reserves	3,645,569	3,537,809	3,382,740	107,760	3.05	262,829	7.77
Total capital accounts	5,421,032	5,308,680	5,131,328	112,352	2.12	289,704	5.65
Total liabilities and capital accounts	85,987,376	83,413,260	85,657,811	2,574,116	3.09	329,565	.38
Ratio of loans to total deposits	25.19%	24.30%	19.78%				

NOTE: Minus sign denotes decrease.

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TREASURY DEPARTMENT

Washington

FOR RELEASE, MORNING NEWSPAPERS
Tuesday, November 25, 1947.

Press Service
No. S-539

The Secretary of the Treasury announced last evening that the tenders for $1,200,000,000, or thereabouts, of 90-day Treasury bills to be dated November 28, 1947, and to mature February 26, 1948, which were offered November 21, 1947, were opened at the Federal Reserve Banks on November 24.

The details of this issue are as follows:

Total applied for - $1,606,910,000
Total accepted - 1,202,745,000 (includes $38,460,000 entered on a non-competitive basis and accepted in full at the average price shown below)

Average price - 99.765 Equiv. rate of discount approx. 0.940% per annum

Range of accepted competitive bids:

High - 99.780 Equiv. rate of discount 0.880% per annum
Low - 99.764 " " " " 0.944% " "

(85 percent of the amount bid for at the low price was accepted)

Federal Reserve District	Total Applied for	Total Accepted
Boston	$ 1,810,000	$ 980,000
New York	1,504,928,000	1,150,678,000
Philadelphia	18,610,000	1,910,000
Cleveland	1,750,000	1,450,000
Richmond	2,995,000	2,495,000
Atlanta	2,075,000	1,675,000
Chicago	40,041,000	16,416,000
St. Louis	4,025,000	4,025,000
Minneapolis	3,435,000	3,135,000
Kansas City	7,644,000	7,569,000
Dallas	9,187,000	8,602,000
San Francisco	10,410,000	3,810,000
TOTAL	$1,606,910,000	$1,202,745,000

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TREASURY DEPARTMENT

Washington

Statement by Secretary Snyder on Inflation Control, before the House Banking and Currency Committee.

November 25, 1947

Mr. Chairman and Members of the Committee: I appreciate your invitation to appear before this Committee to discuss certain phases of the program for the control of inflation outlined in the President's message of November 17.

It is of the utmost importance that we extend early aid to the Western European countries in order to assure that people will not go hungry and cold this winter and to assure their continued participation as free nations in the world economy. It is equally necessary that this aid be extended without subjecting our economy to the strain of further inflation.

Both of these things are essential if we wish to maintain a national environment and a world environment in which peace and freedom can continue to develop. If we fall short of our goal in foreign aid, our own freedom could be threatened by external forces; and, if we fall short of our goal in controlling inflation, we will be threatened by the danger of economic collapse at home. We must avoid both dangers.

I have been invited to appear before you this morning on one phase of the anti-inflation program. As you know, testimony in support of the emergency program for European assistance has been presented by representatives of the Departments of State, Commerce and Agriculture.

The President outlined three types of measures for the control of inflation; one, measures to relieve monetary pressures; two, measures to channel scarce goods into the most essential uses; and, three, measures to deal directly with specific high prices.

It is to the first of these measures that I will give attention, as other representatives of the Administration have been invited to discuss items two and three.

Anti-inflationary measures which may be taken in the monetary field are of course but a segment of the whole program, and could not, by any means, solve the problem alone. But such steps as can be taken when related to those in other fields will of course be helpful in the overall solution.

The President is greatly disturbed in regard to price inflation, which threatens our whole economic structure, and he is convinced that the Congress is equally concerned.

The President has laid special emphasis on voluntary actions on the part of businessmen, labor leaders, farmers, and consumers to hold prices down. Intensified efforts will be continued to obtain voluntary restraint. Certain powers are necessary, however, to fortify the voluntary efforts.

The President has suggested that consideration be given to the following monetary measures: one, that Consumer Credit Controls should be restored; two, some restraint should be placed on inflationary bank credit; three, Legislation should be provided to prevent excessive speculation on the Commodity Exchanges; four, intensified activity in the sale of savings bonds.

The last item is the only one of those suggested which comes completely under the jurisdiction of the Treasury Department, and I shall devote my time principally to a discussion of that particular item. I shall touch but briefly upon the remaining three as they are primarily the concern of other government Departments and are being discussed by representatives of those Departments as they appear and testify.

Item one, "restoration of Consumer Credit Controls", will be discussed by Federal Reserve officials. I am in favor of the restoration of those controls.

The most effective types of credit control are those which strike at the individual forms of credit extension which are contributing to inflationary pressures. The most important single form of such credit extension at the present time is in consumer credit.

Total consumer credit outstanding at the end of September reached an all-time peak of $11,400,000,000. At the end of 1945, it amounted to only $6,600,000,000. Prior to December 1946, total consumer loans outstanding at any one time had never reached the $10,000,000,000 level.

This increased use of consumer credit in the present period of inflationary pressures can only add to those pressures. As we all know, the curtailment of the production of consumer goods during the war period gave rise to a tremendous deferred demand for such goods. As we all know, despite the fact that industrial production during 1947 has reached the highest level ever attained during peacetime, we have not yet been able to produce enough goods to satisfy this deferred demand. There still exist many important shortages of goods. But with production near capacity levels, purchasing power made available by consumer loans can be used only to bid up prices of consumers' goods, not to purchase more goods. It is imperative, therefore, that efforts be made to restrain the demand for scarce goods until supply approaches demand.

Money market interest rates form a small part of the total cost of consumer credit, and changes in such rates are almost powerless to limit its extension. It is necessary to cover specifically by regulation such matters as minimum down payments and the maximum periods over which payments may be spread on installment purchases of consumers' goods in order to restrain this type of inflationary credit.

In reference to the matter listed under item two, "some restraint should be placed on inflationary bank credit", this is a matter under the jurisdiction of the Board of Governors of the Federal Reserve System which has responsibility for overall bank credit control. However, the Treasury Department, due to its responsibility on debt management, has been actively studying this field for some time. Some of the Treasury activities in this connection cover debt management, interest rate adjustments, and study and recommendations regarding bank credit trends.

I must point out here, that the Treasury must continually measure the effects of bank credit controls against the problems of debt management. The management of the public debt since the close of the war has presented a continuing problem.

The public debt reached its peak of $280 billion on February 28, 1946. During the following ten months, it was reduced over $20 billion, reflecting the reduction in the cash balance in the Treasury from a wartime to a peacetime level. Almost all of the reduction in the debt during this period took place in the holdings of Government securities by commercial and Federal Reserve Banks. Since the end of 1946, the debt has remained substantially constant, reflecting the approximate balance of the budget during this period. Holdings of Federal debt by commercial and Federal Reserve Banks have nevertheless continued to be reduced and fell by over $6 billion in the first ten months of the year, with holdings by nonbank investors increasing correspondingly.

The concentration of debt reduction during 1946 on securities held by banks and the transfer of over $6 billion of debt thus far in 1947 from bank to nonbank hands have been, in large part, the consequence of the public debt policies of the Treasury and of the restrictive credit policies of the Federal Reserve System. These policies have contributed substantially to the fight against inflation, and will be continued as long as they are appropriate. I should like to note in this connection that a sizable reduction in the public debt will be possible during the early months of 1948 -- during which months will occur most of the excess of Government receipts over Government expenditures predicted for the entire fiscal year.

To minimize bank credit expansion, restrictive measures have been applied to the money market by the Federal Reserve System and the Treasury. This has been reflected by a rise in interest rates and a better balance between short and long term rates.

The average rate on 90 day Treasury bills has increased from 3/8 of 1 percent in early July to nearly 1 percent at the present time; while the rate on 1-year Treasury certificates of indebtedness has risen from 7/8 of 1 percent to 1-1/8 percent in the same period. During this time the yield on the longest-term Treasury bonds -- those issued in the Victory Loan -- has risen from a little over 2.30 percent to about 2.43 percent.

The entire debt management policies of the Treasury since February, 1946 have been of an anti-inflationary character. First, there was the paying off of bank-held Government debt out of excess cash balances; second, there has been a payment on bank-held debt out of funds derived from (a) budget surplus, (b) trust funds, and (c) the sale of savings and investment bonds to the public; third, pressure on the money market with slightly higher interest rates. Through the payment and calling of maturing bonds and refunding them into short term issues, it has been possible to create an interest pressure on the money market without an increase in the net cost of the market debt to the Government.

In making our decisions with respect to public debt management, we must constantly weigh the restrictive effect of any proposed debt management action against its cost in added interest burden on the taxpayer. An increase of 1/2 of 1 percent in the average cost of carrying the public debt, for example, would mean an added burden of $1-1/4 billion a year on the taxpayer.

At the present time, as you know, the interest cost on our public debt amounts to more than $5 billion per annum. This is a large figure and may increase in the future if a larger proportion of our debt is carried in longer-term securities requiring higher coupon rates of interest. It is, therefore, imperative that during these times of great prosperity we should continue to collect adequate revenues over and above a balanced budget to provide for a systematic reduction of the debt total. A reduction in the debt through a substantial budget surplus is the most anti-inflationary measure that can be taken in the fiscal field.

In the field of commercial bank loan credits, the Treasury Department, through the Comptroller of the Currency, has been very active in studying trends and taking steps to induce a restraint in inflationary bank loans.

A few weeks ago, we had the District Chief National Bank Examiners in for a conference, at which time the credit situation was discussed at some length. The Chief Examiners were instructed to have their examiners, during the course of examination of banks, counsel with and caution bankers against speculative lending policies.

More recently, the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Executive Committee of the National Association of Supervisors of State Banks have collectively taken steps to urge the curtailment of all loans either to individuals or businesses for speculation in real estate, commodities, or securities. In a joint statement issued this morning by these agencies all bankers are urged to confine the current extension of bank credit to the greatest extent possible under existing conditions to financing that will help production rather than increasing consumer demand.

Item three, Secretary Anderson of the Department of Agriculture will present testimony on legislation that should be provided to prevent excessive speculation on the commodity exchanges.

Item four makes recommendations for the intensification of activity of savings bond sales as an anti-inflationary action.

As the President said in his message of November 17:

"Another effective weapon against inflation is increased savings by the public. Every dollar that is saved instead of spent is a dollar fighting against inflation. In order to encourage additional savings, the Government should intensify its vigorous efforts to sell savings bonds."

Since the war, as an economy measure, the Treasury Department has curtailed enormously the organization of the savings bonds division, and has resorted primarily to those programs for which the voluntary cooperation of individuals and businesses could be recruited. While this procedure has been eminently successful and has produced most satisfactory results in maintaining bond sales in excess of bond redemptions, it still has its limitations.

Up to now the day-to-day efforts of the Treasury savings bond sales organization has been to maintain the popularity of the payroll savings plan among American workers and to sell to the American people the idea of investing regularly for their own good. This program has formed an important part in the Treasury's fiscal policy.

During the war it was obvious to people why we needed the savings bond program. Everyone could see that the Government needed dollars -- over and above taxes -- to buy munitions and pay wages and subsistence for our armed forces. Each of us had someone - son, daughter, brother, sister, loved one - in service and therefore had a direct interest. And, in addition, everyone could understand that savings bonds helped to absorb inflationary dollars which were accumulating at a rapid rate because incomes were growing while goods and services available for purchase were not increasing accordingly due to the fact that war goods were using up materials and labor.

But now that the war is over many people do not understand the importance of the savings bond program today.

The savings bond program absorbs excessive purchasing power in the hands of individuals. This cuts down spending pressures. For this reason, emphasis is being placed -- and will continue to be placed -- on the payroll savings plan for workers and on bond programs for individuals, and especially farmers. The important funds to obtain are the small amounts invested regularly by millions and millions of people. It is the money which is more likely to go on a spending spree that is the most important to get invested in savings. The investor we want most is the individual -- the worker with good income and the farmer whose income is at a high level.

Bond sales of this character are important from a fiscal point of view even if we have a balanced budget, for they widen the ownership of the debt and provide a sounder debt structure. At the same time the sale of these savings bonds makes an important contribution to the control of inflationary pressures.

It withdraws funds in the hands of the individual from the spending stream thus providing funds which enables the Treasury to retire bank held debt. This in turn results in a reduction of the money supply in the economy.

In order to increase the sale of United States Savings Bonds, however, we have an intensive selling job to do.

The Treasury Department is ready to move right away on an enlarged savings bond sales activity. But this increased sales activity will require additional funds over those earmarked for this purpose in the budget for fiscal 1948. We are therefore asking the Congress to give approval to the use of additional funds for the savings bond program over and above those approved in the budget.

The present greatly reduced staff in Washington and in the field can be expanded immediately. With additional personnel and funds for promotion, the number of purchasers on payroll savings plans can be greatly increased and the sales of savings bonds materially multiplied.

Incidentally, I think that you would be interested to know that total sales of savings bonds are continuing to exceed - redemptions and the volume outstanding has reached a new high - nearly $52 billion. In E bonds alone there are $30,894,000,000 outstanding; this volume is today within one-quarter of 1 percent of the peak volume of E bonds outstanding at the close of the Victory Loan nearly two years ago. We have been able, in other words, to increase the savings bond total and to sustain the volume of E bonds outstanding throughout this period of postwar readjustment.

This has been a tremendous accomplishment. There were those, you remember, who predicted that the termination of the war would be followed by wholesale cashing of savings bonds and the liquidation of much of the effect of the wartime savings bond sales effort. The truth is that this just didn't happen. The redemption record of United States savings bonds is a cause for considerable gratification for all of us. It is a tribute to the people who sold the bonds during the war and to the people who purchased them. I am confident that with the additional effort that will be provided by additional funds, good results can be obtained.

I have with me today representatives of the Treasury Savings Bonds Division who are prepared to present, with your approval, some interesting statistics in this field.

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TREASURY DEPARTMENT
Washington

FOR RELEASE MORNING NEWSPAPERS
Monday, December 1, 1947

Press Service
No. S-541

Alternative methods of widening the Social Security system are examined in a study released by the Treasury Department today under the title "The Extension of Old-Age and Survivors Insurance to Agricultural and Domestic Service Workers and to Self-Employed Persons."

Prior to the war about 2,600,000 persons were engaged in domestic service at any one time, most of them women. During 1946 about 3,500,000 persons worked as hired agricultural workers, but the number varied seasonally. There are about 11,000,000 self-employed persons, farm operators constituting the largest single occupational class — about one-half the total number. Large portions also are in retail trade, service industries and the professions.

Congress postponed application of the old-age and survivors insurance program to these and certain other groups when the Social Security Act was adopted in 1935. Coverage was limited to employees in commercial and industrial enterprises, it being felt that administrative experience should be accumulated before other groups were brought into the system.

Operation of the social insurance program for ten years and developments in other tax fields have produced much helpful data and resolved some of the problems envisaged at the time the program was inaugurated. It is now evident that administrative considerations no longer constitute an important barrier to the expansion of coverage, in the event the Congress decides to extend the protection of the system. How to manage the collection of the Social Security taxes from the groups proposed for coverage is, however, a primary problem.

The study released today does not attempt to answer the public policy question involved in extending coverage, nor does it contain specific recommendations. It describes three plans which might be employed for the extension of coverage to agricultural and domestic workers. They are: (1) the return system currently employed under the program; (2) the present return system supplemented by employee wage books, or book-return system; and (3) the present return system supplemented by a stamp system.

The present system requires each employer affected to withhold the employee's social security tax from his wage payment, to keep detailed records of both wages and tax, and to remit both the employee's and the employer's tax with a return each quarter.

Under the book return system, small employers not accustomed to keeping permanent records would not be required to institute them, or to fill out detailed wage payment schedules for payroll tax purposes. Instead, the employer's work would be simplified through the use of wage books, one for each employee, with detachable sheets. The sheets would serve as returns for reporting taxes and wage payments.

Under the stamp system, each employee would have a stamp book, and the tax would be paid through the purchase of stamps by the employer and his affixing them to the book as taxes fell due. The stamps accumulated in a book would represent the employee's continuing wage and tax payment record. An employee would receive a new stamp book twice a year and would return his old book to the Social Security Administration, where his social security account would be credited for the wages represented by the stamps in his book.

Both the wage-book plan and the stamp plan are regarded as supplements to the present return system which would be used wherever practicable.

The plan discussed for the coverage of the self-employed would require such persons to file social security tax returns and pay the tax directly to the collectors of internal revenue, much as taxpayers now file income tax returns.

The self-reporting plan calls for the imposition of a tax on self-employed persons measured by selected items of income reported for income tax purposes. It would segregate that part of total income most nearly comparable to wage income and analogous to earned income, and the social security tax would be paid on such income not in excess of $3,000, less amounts which have been subject to payroll tax withholding.

Segregation of earned income from total self-employment income is essential to place the self-employed on a par with recipients of wages so far as concerns the imposition of the social security tax. Procedure for effecting this segregation is laid down in the plan. The study covers such problems as joint returns, community property, partnerships, etc.

An appendix to the study gives a detailed comparative description of plans for the coverage of agricultural and domestic employees. A second appendix enumerates items which would enter into the computation and reporting of the self-employment income.

THE EXTENSION OF OLD-AGE AND SURVIVORS INSURANCE TO AGRICULTURAL AND DOMESTIC SERVICE WORKERS AND TO THE SELF-EMPLOYED

Division of Tax Research, Treasury Department
November 1947

The Extension of Old-Age and Survivors Insurance to Agricultural and Domestic Service Workers and to the Self-Employed

The present social security system provides old-age and survivors insurance protection to employees in commercial and industrial enterprises. It leaves other categories of workers, including self-employed persons and agricultural and domestic service employees, without such protection. At the time of the adoption of the Social Security Act of 1935, the Congress postponed application of the program to these groups because of special administrative difficulties, pending the accumulation of administrative experience with a more limited program. In the meantime, the case for extending the old-age and survivors insurance program to these groups, among others, has been gaining increasingly wide recognition. This report explores alternative methods of achieving such extended coverage. It does not contain any specific recommendations, and is designed to facilitate discussion of the relevant issues by providing analytical and background material.

The study was prepared in the Treasury Department by representatives of the Bureau of Internal Revenue, the Office of Tax Legislative Counsel, and the Division of Tax Research. Valuable assistance and suggestions were received from the Bureau of Old-Age and Survivors Insurance of the Social Security Administration and the Staff of the Joint Committee on Internal Revenue Taxation, but the material contained herein does not necessarily represent the views of these organizations.

Division of Tax Research
U. S. Treasury Department

November 1947

The Extension of Old-Age and Survivors Insurance
to Agricultural and Domestic Service Workers
and to the Self-Employed

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The Extension of Old-Age and Survivors Insurance to Agricultural and Domestic Service Workers and to the Self-Employed

I. INTRODUCTION

The Social Security Act, approved on August 14, 1935, provided the United States for the first time with a general old-age insurance program and shifted this country from among the more backward to the more advanced countries in the field of social security. Its comprehensive character, notwithstanding, the 1935 Act provided old-age insurance coverage for only part of the country's population; it left large groups of people outside the program.

The principal groups excluded from the benefits of the old-age insurance program were agricultural workers, domestic service workers, self-employed persons, governmental employees, employees of educational, religious and charitable organizations, and persons employed in the railroad industry. In 1946 these categories included about thirty million people and represented approximately 40 percent of the country's paid employment.

The exclusion of the several groups from the program was prompted by different reasons. Railroad employees were covered by a separate system established by the Railroad Retirement Act of 1935. Governmental employees were excluded partly because some were covered under existing pension schemes and partly because of legal barriers to the imposition of a Federal tax on State and local governments in their capacity as employers. Less tangible reasons lay behind the exclusion of the employees of educational and other non-profit organizations.

Agricultural and domestic workers, and self-employed persons, now aggregating about 19 million, were not covered principally because the administrative problems in collecting taxes and obtaining proper wage reports were anticipated to be especially difficult. The concept of social security was new to this country and the introduction of a social insurance program represented a significant departure both for the Federal Government and the American people. In the initial stages of the program, it appeared desirable to restrict old-age insurance to those areas of employment where the prospects for successful operation were best. Moreover, it was anticipated that as administrative experience was accumulated, non-covered groups could be brought in at some future time without jeopardy to the entire system. It was made abundantly clear at all stages of the discussion that the exclusion of these groups from the initial program was a matter of expediency and in no way implied a permanent denial of the rights of these groups to old-age security on terms identical with those accorded to the covered groups.

In the case of the self-employed, the basis for exclusion was largely administrative in character and related to the problem of collecting taxes from self-employed persons with low incomes. The financial structure of the contributory old-age insurance system adopted in 1935 was built around employer and employee taxes on wages collected at source. It placed primary compliance responsibility on the employer and avoided the need for returns on the part of individual wage earners. This mechanism obviously was not applicable to the self-employed where employer and employee are one and the same person. The financing of social security benefits for the self-employed had to be built around some alternative structure involving self-reporting by covered persons. The mechanism which held most promise appeared to be an adaptation of the procedures used for income tax purposes. Since, however, the income tax of those days employed large personal exemptions and was a tax payable by a relatively small segment of the population, its adaptation for social security purposes would have required innovations which were then regarded to involve too much risk. The retention of income tax exemptions for old-age insurance purposes would, in effect, have entailed the exclusion of precisely those self-employed persons who were most in need of social security protection. The drastic reduction of exemptions or their complete elimination, on the other hand, involved questions of enforcement practicability which were then difficult to appraise.

Another problem which had to be resolved preparatory to the assessment of taxes against the self-employed related to the separation of that part of their income attributable to personal services from the balance due to capital investment. The tax which comprises a contribution for old-age security should apply only to the counterpart of wages -- to personal service income which stops when the worker retires and which establishes both the timing and the scale of his retirement benefits. Here again, income tax experience was relevant and indicated that this type of segregation was fraught with difficulties.

The principal consideration which influenced the decision to delay the coverage of agricultural and domestic workers under the original social security program related principally to the enforcement of social security taxes and adequate wage reports. A lesser problem was the valuation and taxation of income received in kind.

Since under the program eligibility for benefits and the size of those benefits were to depend upon earnings, it was essential to obtain a complete and accurate record of the earnings of each agricultural and domestic employee. This required employers to establish and maintain records of each wage payment made to their employees. While some employers were already keeping records of this type, it was believed that most farm operators and particularly housewives would find it burdensome to comply with the requirements, both because of their unfamiliarity with record-keeping and because of the rapid labor turn-over.

During the ten years of the old-age and survivors insurance system, the need for the expansion of its coverage has frequently received public recognition. In 1938 the Advisory Council on Social Security, established jointly by the Senate Finance Committee and the Social Security Board, recommended in its final report the coverage of most excluded occupations as promptly as possible. This was followed by similar recommendations made by the Social Security Board and the President, just prior to the commencement of the Congressional hearings which led to the 1939 amendments of the Social Security Act. That legislation made important revisions in the system but, except for several small groups, failed to broaden the coverage of the program.

Interest in expanded coverage continued. The Social Security Board recommended the enactment of legislation to this end in virtually every one of its annual reports. From time to time the President made similar recommendations to the Congress. In his 1946 Budget Message and again in 1947, President Truman called attention to the absence of social security protection for large segments of the population particularly in need of old-age security, and suggested legislation to eliminate the existing inequity.

During every session of Congress a number of bills were introduced providing for the extension of coverage either as a separate step or as part of comprehensive social security revision. Notable examples of recent proposals are those sponsored by Senator Wagner, Senator Murray and Representative Dingell for broad changes in the entire social security program, and by Senator Magnuson to provide a separate retirement program for all those not covered by existing Federal retirement legislation. The legislation pending in this session of Congress is illustrative of the varying approaches to the general problem. Senator Murray's bill (S. 1679) would make extensive revisions in the program including expanded coverage. Senator Magnuson has re-introduced his bill (S. 681). Representatives Curtis (H.R. 2046) and Bennett (H.R. 3457) propose coverage for the self-employed. Bills introduced by Senators Young (S. 508), Aiken and McFarland (S. 1743), and by Representatives Beall (H.R. 2022), Lynch (H.R. 2448), Curtis (H.R. 1892) among others would extend old-age and survivors insurance to other groups not now protected by the program.

The Ways and Means Committee undertook an investigation of various phases of the social security program, including expanded coverage, in 1945-46. Its staff of technical experts (appointed pursuant to H. Res. 204, 79th Congress, 1st Session), in reporting on this aspect of social security revision, concluded that it was feasible to extend coverage to the self-employed and to agricultural and domestic workers. Following the report of the Technical Staff, the Committee conducted extensive hearings. Virtually every witness who addressed himself to the problem, including representatives of business, labor, farm organizations, Government, and religious, welfare and educational groups, favored extension of coverage to these categories of workers. In his testimony before the Committee, Commissioner Altmeyer of the Social Security Administration emphasized the need for extending the coverage of old-age and survivors insurance, and presented in some detail a plan for covering self-employed persons. Agricultural and domestic workers, he indicated, might be covered either by a stamp plan or by a system of employer reports.

The growth of interest in the extension of social security coverage during the past ten years was accompanied by the accumulation of administrative experience which resolved some of the problems envisaged at the time the program was first developed. The wartime reduction of personal exemptions under the individual income tax to $500 per taxpayer provided experience with tax returns from low income recipients. In the case of most farm operators and many employers of domestic service workers, it established the need for the maintenance of operating records. These developments have direct application to the problem encountered in the extension of old-age insurance coverage. Other developments, such as the farm aid programs and rationing, have contributed to making the population record conscious. Administrative authorities have acquired more than ten years of experience in enforcing social security taxes under diverse circumstances. At the same time, the generally high level of economic activity, including employment, reduced the rate of labor turn-over in domestic employment and the burdensomeness of employment taxes. These developments have improved the case for the extension of old-age insurance coverage.

The present report, which draws heavily on the Treasury Department's experience with the administration of the tax aspects of the social security system, examines the problems of extended coverage and discusses alternative plans for bringing the self-employed and the agricultural and domestic workers into the system. In examining the available alternatives, it appeared desirable to confine detailed consideration to those plans which were consistent with the principal characteristics of the existing social security system. Consequently, some plans which under other circumstances would deserve careful evaluation were not considered.

The present social security program is financed by a payroll tax imposed at a rate of one percent each on employees and employers. The receipts from this tax have been sufficient to pay the current cost of benefits and to build up a substantial reserve, and are expected to continue to do so for some years to come, notwithstanding anticipated increases in aggregate benefit payments. It is estimated on the basis of a relatively optimistic set of consistent assumptions regarding the long-term operations of the system (high wages, low retirement rates, etc.), that the level cost of the system is about 3 percent of payrolls. Under a less optimistic set of assumptions, the level cost of the system is estimated at approximately 7 percent of payrolls. Nevertheless a combined tax rate of only 2 percent has been continuously in effect since the origin of the program, with the result that the system has been operating at an actuarial deficit, even if the most optimistic set of economic and demographic assumptions underlying the calculations made thus far should materialize. In the absence of an adequate increase in the payroll tax, the deficit will presumably be made up from the Government's general fund when the cash benefit obligations of the system warrant it.

This prospective dependence of the system upon some financing from the general fund prescribes in some measure the plans available for the coverage of hitherto uncovered groups. It precludes, for instance, recourse to a plan for voluntary coverage. Under such a plan, those who could best afford to come into the system would do so, while some of those whose need for protection is greatest would not acquire social security coverage. As a result the general fund would tend to subsidize social insurance protection for the benefit of a select group of individuals who need it less than some of those not covered. To safeguard the principle that the Government's general funds serve the purposes of all the population on a fair and equitable basis, it is necessary to limit the choice of plans for the extension of coverage to those which extend protection on the basis of reasonably fair classifications. Voluntary coverage, dependent as it is on the financial position of the insured, would not meet this test. It should also be noted that there are other objections to a voluntary system. For example, it would tend to involve an adverse selection of risk and would thus impose added financial burdens on those who are compulsorily covered by the program.

A further illustration of how the characteristics of the present system restrict the alternative approaches to broader coverage may be cited. From some points of view, there is much to be said for a plan of direct reporting by agricultural and domestic workers themselves by means of an annual return of wages and payment of taxes, similar to that required under the income tax and under a plan discussed below for self-employed persons. Such a plan would preclude the collection of a tax from the employers of such workers, and would involve corresponding discrimination between employment in commerce and manufacturing and employment in agriculture and domestic service. Moreover, it is likely that such a plan would have to exclude a substantial number of employees. It was for these reasons ruled out of consideration.

The plans developed below accord closely with the requirements of the existing social security program. They deal only with the tax collection aspects of the problem. No attempt has been made to develop specific benefit provisions appropriate to the proposed tax plans. Since, however, the plans have been molded as nearly as possible to the present benefit structure and its qualifying provisions, the development of parallel benefit provisions should not present special difficulties.

It should be noted, also, that this analysis of alternative approaches to extending coverage involves of necessity a large element of judgment. The advantages claimed for one approach as against another, are to a large extent based upon tax collection experience under different circumstances than those which will prevail when coverage is extended. We have had, for example, extensive experience with the taxation of low incomes. Nevertheless, if in conjunction with a tax on the self-employed with low incomes, a program of benefits directly related to that tax were introduced, past experience would not necessarily provide a reliable gauge of the compliance to be expected. The payment of benefits introduces a new factor which may produce more favorable results than those obtained when no quid pro quo was associated with payment of the tax.

On the basis of the studies that have been made, it appears evident that administrative considerations no longer constitute a barrier to expanded coverage. The administrative problems are difficult, as was the case when the existing program was initiated, but given a moderate period of experience and adequate appropriations for the administration of the enlarged area of coverage, they can be resolved. Moreover, tax collection features and costs are but some of the factors to be considered. Other elements such as equity among different groups and the possible reduction of public assistance costs which are borne out of general revenues, as well as public attitudes toward social security and other social considerations, also enter into the evaluation process. Whether the old-age and survivors insurance program is to afford protection to segments of the population now deprived of its benefits, is a question of public policy to be determined in the light of these considerations.

II. PLANS FOR THE COVERAGE OF AGRICULTURAL AND DOMESTIC WORKERS

A. Introduction

The basic problem inherent in the extension of old-age and survivors insurance coverage to agricultural and domestic service workers is associated with the economic characteristics of these groups. The small number of employees per employer, the comparatively low level of wages, the relative frequency of seasonal work, the geographic dispersion of employers, the lack of employee organizations and the inadequacy of employer records make for costly administration. Although the feasibility of coverage in this area cannot be assessed primarily on the basis of a comparison of the ratio of cost of administration to tax collections with that under either the present social security program or the Federal tax system as a whole, the consideration is relevant, and together with the cost of maintaining records required for the determination of benefits, will have an important bearing upon the evaluation of the alternative plans described below.

The average number of workers per employer under present coverage is high compared with that in agriculture and household employment, approximately 20 employees in commerce and industry and only about 1.5 in agriculture and even less in domestic service. To be sure, these averages exaggerate the differences between these broad groups. It is important to note that despite the high average per employer under present coverage, fully one-half the employers have three or less employees and more than one-fourth have only one employee. Likewise, the low average in agriculture tends to obscure a high degree of concentration. Thus, about 600,000 farm operators in 1945 (about one-fifth of the agricultural employers) employed 80 percent of the hired farm labor used in that year. While there are large areas within agricultural and domestic employment in which the costs of administration would compare with those now involved in collecting contributions from small industrial employers, the average cost for the group as a whole would be higher. A low average number of employees per employer means a relatively small amount of tax per return and relatively high administrative and enforcement costs in relation to collections. 1/ Under existing coverage, collection costs amounted to 71 cents per $100 of revenue for fiscal year 1946, and with broader coverage this ratio would undoubtedly be increased (assuming no change in tax rates).

Another consideration, relevant in the case of domestic employment, is that wages paid to domestic workers in a private home are not allowable as a deductible expense in computing net income for income tax purposes and hence the income tax cannot act as a deterrent to under-reporting of social security taxes in this area. Still another consideration is the circumstance that the proportion of employees who are seasonal or part-time workers and shift from one employer to another during the course of their annual employment is much higher in agriculture and domestic service than in commerce and industry.

1/ It should be noted, however, that the unit cost of covering other non-covered groups, such as employees of non-profit institutions and Government employees, may be expected to be less than for agricultural and household employment. Consequently, with a program of complete coverage, costs in relation to collections may not be significantly greater than at present.

1. Domestic employment

Prior to the war about 2.6 million persons were engaged in domestic service at any one time. 1/ This may be assumed to represent roughly the normal force in this occupation, although in periods of full employment it may be considerably smaller because of other more attractive employment opportunities. The great majority of domestic workers are women. 2/ There were about 1,650,000 employed domestic workers in July 1946, of whom 100,000 were men. About one-fourth of the women were married and living with their husbands, according to the last population census. About 27 percent were 45 years old or over, 3/ and more than half were of the white race. In the country as a whole, almost one-third of the domestic workers lived in rural areas.

An estimated one-third of the domestic workers were "living-in," according to sample statistics from the 1940 census. In all, one-half of the domestic workers had jobs the year round, and may be considered regular full-time employees. Another fourth may also have been regular employees on a part-time basis, but their number is indeterminate. Data on the number of employers of domestic labor are not available, but as a working basis it is assumed that on the average there are three employers for every two domestic workers.

Earnings were very low for most domestic workers before the war. The annual median cash earnings of full-time workers amounted to less than $400. The extent to which these earnings were augmented by income-in-kind is unknown. It is likely that in addition to those "living-in," many other domestic workers received some income in kind. There is some scattered evidence that cash wages of full-time domestic workers have more than doubled since the beginning of the war. Taking into account the volume of part-time employment, the average cash wage of domestic workers may still be only $700 or $800 annually.

A pre-war survey of white domestic workers in Chicago revealed that approximately one-sixth of the workers had been employed in covered industry sometime since the enactment of the program. It is likely, however, that a much larger proportion of such workers acquired some social security coverage during the war which, in the absence of expanded coverage, will be lost.

1/ If chauffeurs, gardeners and practical nurses are excluded, the total is about 2.3 million persons. The proportions and percentage figures in this section are based upon the smaller total.
2/ In 1940, only 150,000 men were in this occupational group.
3/ Among female clerical and sales workers only 13.7 percent were in this age group.

2. Agricultural employment

During 1946, about 3.5 million persons worked as hired agricultural laborers. The number of workers grew from a more or less permanent force of about 1 million employed at the beginning of the year to about 3 million in the fall harvest period. Thirty-three percent of these workers reported that farm wage work was their major activity and the only kind of work they had done in 1946. This 33 percent of the workers, which included most of the regular hired hands, accounted for 60 percent of the total time worked at hired farm work during the year. In contrast, the school youths, the housewives, and the miscellaneous group--that together made up 27 percent of all the workers -- accounted for only 10 percent of the days of hired farm labor. They were used mainly in seasonal rush jobs. An additional 19 percent (534,000) reported that they operated a farm during 1946 and for most of these, hired farm work was secondary to the operation of their own farms. This group accounts for 12 percent of the hired farm work done during the year. Twenty-six percent of the farm wage workers, however, also had earnings from nonfarm work. This group which represents the overlap of the farm and nonfarm labor market accounted for 18 percent of the hired farm work done during the year.

Geographically, the southern States account for the largest proportion of hired farm workers. Depending upon the season, this area accounts for between 40 and 50 percent of the workers. The western and north central States each account for about one-fifth and the northeastern States for the remainder.

About three-fourths of the hired farm workers in 1945 were men, more than half of whom were heads of households. Among the women only about 10 percent were heads of households. Many of the farm workers are young people, about 20 percent of the men and 30 percent of the women being less than 20 years old. However, almost one-third of the men may be 45 years of age or over.

The earnings of agricultural workers vary geographically and according to whether they are regular or seasonal workers. The lowest wages are earned in the South and the highest in the West. In September 1945, average daily earnings ranged from \$2.90 in the southern to \$6.80 in the western States. The farm wage bill for 1943 divided by the average monthly number of farm workers indicated an average wage of approximately \$800. In 1939, the median cash income of farm workers was approximately \$260.

Another factor entering into the earnings of agricultural workers is the wages-in-kind which they receive. The most important perquisite item is housing. In September 1945, about 36 percent of the farm workers received lodging or were allowed the use of a house, including 14 percent who received both housing and meals. Only 3 percent received meals but no housing. Although perquisite items are furnished to regular workers more frequently than to seasonal workers, over one-fourth of the latter received meals or housing or both. Other types of perquisites are also given to agricultural workers, such as the use of a garden plot, equipment, animals, and produce. In the aggregate, the value of perquisites is estimated by the Department of Agriculture to have been about $350 million in 1945. The values of perquisites given to individual workers are not available, but related data indicate that the daily value of meals ranged from 40 cents in South Carolina and Louisiana to $2 in the State of Washington.

Although there were nearly 6 million farms in 1945, only about 2.8 million used hired workers. Probably less than one-half million used hired labor throughout the year. The others employed workers for varying periods of time, but in most cases the total amount of labor hired was small. During 1945 there were an estimated 1.7 million farms each using less than 75 man-days of hired labor. On the average, these farms used only 20.9 man-days, and in the aggregate they accounted for only 7.6 percent of the total number of hired man-days during the year. The annual cash wage bill on these farms averaged less than $100.

The remaining 1.1 million farms hired considerably more labor during 1945. About one-half million farms hired up to 250 man-days of labor. On the average, these farms used 119 man-days of labor and had an annual cash wage bill of about $550. Another 600,000 farms, using 80 percent of the hired manpower employed during the year, makes up the 2.8 million farms. These farms used at least one-man year of labor each and had average annual wage bills in excess of $1,000. The total cash wage bill for hired farm labor in 1945 is estimated at $1.9 billion.

B. Alternative plans of coverage

Several types of mechanism are available for the collection of taxes and wage data with respect to agricultural and domestic employment, ranging from a simple extension of that now in use to one which combines with that system entirely new machinery. The discussion below suggests that a selection from among alternative plans will need to be made on the basis of several criteria, and in the light of a delicate balancing of the technical administrative considerations on the one hand and the desired coverage on the other.

Of the alternative plans which have been considered for extending coverage to agricultural and domestic workers within the framework of the existing system, the three most promising are: (1) the present return system by itself, (2) the present return system supplemented by employee wage books (book return system), and (3) the present return system combined with a stamp system. Each of these would provide the Federal Government with reports of wages paid to domestic and agricultural employees and enable the collection of the two employment taxes - one from the employer and one from the employee. All three plans have one principal feature in common. They provide for the use of the present employer reporting system over a substantial segment of agricultural and domestic employment, within the area where the characteristics of employment are similar to those prevailing in commerce and industry. It is only with respect to the balance of agricultural and domestic employment that the plans differ. They differ also as to their enforceability in irregular and part-time employment with corresponding implications as to the coverage they can provide. The plans differ also as to the manner in which the data would be reported, the Government agency charged with the enforcement, and the effort entailed on the part of the Government, the employer and the employee. A detailed tabular description of these three plans for the coverage of agricultural and domestic workers will be found in Appendix A.

1. Plan I. - Present return system

Plan I consists of the extension to agricultural and domestic workers of the system of quarterly returns now employed under the Federal Insurance Contributions Act.

Under this system every employer and employee is assigned an identification number by the Social Security Administration. Each calendar quarter the employer files with the collector of internal revenue a return (Form SS-1a) which reports the employer's name and identifying number, each employee's account number, name, and quarterly earnings, and the computation of tax liability. The employer withholds the employee's tax from his wage payment, keeps records of both wages and tax, and each quarter remits both the employees' and employers' tax with his return. Periodically or on termination of employment the employer furnishes each employee a statement showing his wages and employees' tax.

The collector detaches the schedule of employee wage information from the return and transmits it to the Social Security Administration where the amount of each employee's wages is posted to his social security account.

The principal consideration in favor of Plan I is its utilization of routines and administrative procedures which have been in use for more than ten years. A number of employers of domestic and agricultural labor are already subject to the requirements of the existing system by reason of their concurrent employment of industrial or commercial workers. The inclusion of their agricultural and domestic employees' wages on their quarterly return should not constitute any serious burden. This plan depends primarily on employer compliance, although it provides some scope for employee participation in enforcement. 1/

Considerable resistance and inertia may be expected at least initially, from employers who are unaccustomed to record-keeping. Unlike agricultural employment, the wages paid for domestic service are not deductible for income tax purposes. Hence there is no incentive, other than for budgeting, for a housewife to keep a record of such wages. The same may be said of the small farm employer who does not file income tax returns. Such resistance might be offset in a number of cases where a close relationship has developed between employer and employee. A respect for law will overcome resistance in many other cases. An educational program encouraging employees to remind their employers to withhold their employee contributions, to insist on their annual or termination receipts for withheld contributions, and to inquire periodically regarding their wage credits at the Social Security Administration would also lend considerable aid to enforcement. An offsetting consideration is the probable unwillingness of some employees to jeopardize their jobs by reporting the delinquency of their employers or to disclose their own income tax delinquencies.

With a view to avoiding troublesome administrative problems associated with the coverage of employees hired by occasional employers, this plan could be drafted so as to exclude the non-business connected services of children under the age of 16, and the services of employees when performed for the employer on less than eleven days in any two consecutive calendar

1/ The Social Security Administration currently issues over 400,000 wage statements annually in response to requests from employees, who have authority under the present system to ask for such statements, to enable them to check on the accuracy of their Social Security wage records.

months, provided that the employer has not paid taxable "wages" to any other employee during the calendar quarter. 1/ Such a limitation would restrict the tax and reporting burdens to the more established employers who generally have a long-term relationship with their employees and may be interested in the old-age security of such employees. The ratio of employees to employers under such a plan would be relatively high, and the amount of taxes due from individual employers would seldom be less than, and generally in excess of, $1 per calendar quarter. Other methods of defining casual labor in these fields might be devised, but experience alone can provide the basis for determining how much further in the direction of complete coverage the present system can be pushed.

2. Plan II. - Book-return system

Under Plan II all employers who keep permanent records of their own (which would include all of the larger agricultural employers) would, upon application to the Commissioner, be permitted, and thereafter required, to follow the same procedures as contemplated under Plan I (quarterly tax and information returns on Form SS-1a). All other employers would be required to file quarterly tax returns but would be under no obligation to keep permanent wage records or to fill out a quarterly wage schedule reflecting the name, social security number and quarterly wages of each employee, as under Plan I.

Each employee would make a written application each year to the Social Security Administration for his annual wage book. The book would consist of a number of sheets, each consisting of a stub and a detachable slip, separated by a vertical perforation. The Social Security Administration would enter the employee's account number (and his name, if practicable) on each sheet of the book. At the time of the first wage payment, the employer would enter the amount of wages, and the date of payment both on the stub and the slip and would initial the stub. The employer would retain the slip and other payments in that quarter would be entered on the same stub and slip. Payments in subsequent quarters would be entered on successive pages in the book. The book would contain instructions and an application blank for a new book. A sample sheet will be found on page 35.

1/ The 11-day yardstick would exclude from coverage the once-a-week domestic worker who may have several employers, each owing an insignificant amount of tax. It has been the principal yardstick under the Federal Insurance ContributionsAct for the exclusion of casuals who perform services outside the course of an employer's trade or business. It should be noted that under such a rule, as under existing law, some occasional employers may not know whether to withhold tax until after an employee's services have been terminated.

At the end of each quarter, the employer would file a tax return identical with the summary (upper) portion of the present Form SS-1a, to which he would attach all the slips taken from the books of his employees. Large employers, and others who keep good records, upon proper application to the Commissioner, would be permitted to dispense with this procedure and would report the wages of their employees in the same manner as under the present reporting system. Such employers, however, would have to advise their employees that the Commissioner of Internal Revenue has specifically waived the requirement of wage entries in employees' books.

While no final determination can be made at this time as to the extent of coverage which might be obtainable under Plan II, the plan as presented contemplates the exclusion of (1) nonbusiness connected services of children under the age of 16, and (2) the services of any employee who works for the particular employer less than three days in any two consecutive calendar months provided the particular employer employed no other covered workers during the calendar quarter. 1/

The main feature of this plan lies in the fact that it would enable many agricultural and domestic workers (particularly casual workers) to bring their interest in their own security to bear much more effectively than under Plan I on employer compliance with the program. Employers using the book-return system would continue to be responsible for filing reports and withholding and paying taxes as under Plan I, but their employees would have a greater opportunity to check employer compliance by insisting upon proper entries being made in their wage books.

The book-return plan, given adequate employee cooperation, would facilitate the task of most employers because the detachable wage slips in the employees' books would enable employers to report the names, account numbers and wages of their employees with the quarterly tax return without establishing a separate recording system for that purpose. The preparation of their quarterly reports would be partly accomplished by the detachment of the wage slips and would not require the transcription of wage data from office records to special reporting forms. In addition, this mechanism would minimize the likelihood of errors in reporting employees' names or account numbers, since employers would not be required to make such entries on wage reports. An offsetting consideration from the viewpoint of employers is their being required to handle wage books and to make entries into them under difficult conditions,

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1/ The 3-day exclusion rule is designed to eliminate the tax and reporting burden of the employer in those cases where employment is casual and of brief duration, and where both the tax and wage credit are likely to be insignificant.

as in the case of payments to farm labor in the field. In addition, some employers who now keep complete records of wage payments may suffer some inconvenience in having to make entries in the wage books. 1/

In affording employees an opportunity to supervise the compliance of employers with the program affecting their own old-age security, this plan would enable employees to safeguard their interest in the program even during the period when the payment of benefits appears to be remote.

The advantage of Plan II from the point of view of the Government, apart from coverage, is the aid to enforcement resulting from employee participation in the system and from the mechanical aids provided the employer. These gains would be secured at the expense of some departure from present procedure. While the basic elements of employer withholding and reporting of taxes and wages would be retained, the procedures now followed by employers, employees and the Social Security Administration would be substantially changed. The wage slips might be especially troublesome to process, as was the case when the social security program was first instituted and slips were used, but the number of such slips would be far less and the processing steps would be far simpler than under the early system. The wage book mechanism would be costly and the extension of coverage to include workers with small earnings might require many returns showing tax liability less than the expense of processing the returns. The value of the enforcement aids inherent in the employees' participation in the program would be reduced to the extent that there is employee resistance to presenting these books to employers every pay day, to filing timely applications for new wage books, and to returning their old books to the Social Security Administration on schedule. The unwillingness of employees to press their employers to report wage payments which would reveal income tax delinquency, and the risk of jeopardizing their own jobs by reporting delinquent employers, would contribute to the reluctance of employees to exploit the advantages inherent in the proposed mechanism. Moreover, since the employer would not be required to retain a copy of the quarterly wage record of each employee (although he would retain a copy of his quarterly tax return showing the total wages during the period), field investigation would in some cases be hampered.

1/ Since the exclusion under the plan might require an employer to wait for three days before determining whether his wage payments are taxable, cases may arise, as they do under present law in connection with non-business casual workers, where an employer may not know whether to withhold tax until after an employee's services have been terminated.

3. Plan III. - Stamp system

Plan III involves the payment of social security tax through a stamp system. But as in the case of Plan II, it contemplates the use of the present reporting system in that area of agricultural and domestic employment where it is practicable from the viewpoint of the employer and the administrative authorities. Prior to 1940 operators of packing and processing plants were covered by the present reporting system and in many cases make similar reports at present to State agencies. With the coverage of agricultural employment, these as well as some other catagories of employers could readily operate with quarterly reports. It would be possible to develop a definition of the types of employers who should report their wage payments in the same way as employers in commerce and industry. In addition, other employers would upon application to the Commissioner be permitted to use the present reporting system. The distinction between employers who would be required to use the present reporting system and those who would be required to use the stamp plan would need to be left to administrative determination on the basis of changing experience. The rules governing the choice of reporting methods would have to be framed in specific terms so that employers and their employees could readily determine which method applies.

In those areas of agricultural and domestic employment which are not covered by the present system, the stamp plan would apply. The social security tax would be paid through the purchase of stamps by the employer and his affixing them to the employee's stamp book. The stamps accumulated in this book would constitute the employee's working record during the period the book is valid. When paying wages, the employer would withhold the employee's tax and affix and cancel stamps in an amount equivalent to the sum of the employer's and the employee's tax.

Each agricultural and domestic employee would obtain a social security account number and a stamp book from the Social Security Administration. The stamp books, valid for six months, would be presented to the employer for affixing the appropriate stamps at the time wages are paid. Each stamp book would contain a detachable form to be mailed by the employees to the Social Security Administration shortly before the end of the 6-month period, applying for new books and listing their current addresses. It would also contain space on which an employee would enter the name and address of any employer who failed to affix stamps, together with the amount and date of wage payments. Upon receipt of the employee's application, the Social Security Administration would issue a new book. At the close of each 6-month period, the employee would send his old book to the Social Security Administration for posting and other processing.

On presentation of completed application forms, employers would purchase social security stamps, available in suitable denominations, from post offices, rural mail carriers, and collectors of internal revenue. In the case of employees who fail to present their stamp books, employers would be required to report on prescribed forms the employees' account numbers, names and wages, and to affix the necessary stamps to that form.

The stamp plan would provide potentially complete coverage for all agricultural and domestic workers. It would abandon the periodic employer-Government relationship inherent in the present reporting system, and would rely for enforcement principally on the willingness of the employer to comply and on the self-interest of the employee in policing the system.

Under the plan, employers would not have to keep any special wage records, or make out any tax returns other than a requisition form in purchasing stamps. The stamps would also serve as the employee's receipt. However, employers would find it inconvenient to purchase and keep on hand an adequate supply of stamps, to process stamps by affixing and cancelling them (sometimes under field conditions), and to handle soiled and mutilated books. Employers would also find it difficult to make wage reports where the employee failed to present his book for the insertion of stamps.

Employees would be afforded an opportunity to take a direct part in safeguarding their old-age security interests, but by the same token, employees would find it relatively easy to alter their wage records by the fraudulent sale or purchase of stamps, thereby either sacrificing their old-age security interest for immediate gains, or obtaining higher old-age benefits than is planned. It should be noted, however, that in order to increase their benefits to any great extent, younger employees would have to alter their wage record over a long period of time. As an additional safeguard, the employee would be required to sign, under penalties of perjury, a "Worker's Declaration" upon submission of his book to the effect that the stamps in the book reflect bona fide employment. The loss of stamp books would penalize employees, unless they could present a satisfactory reconstruction of their earnings record.

From the viewpoint of the Government, this plan offers an opportunity to place the tax collections on a pay-as-you-go basis through the purchase of stamps in amounts related to current operations. At the same time, it would minimize the possibility of erroneous reporting of employees' namesand account numbers. These gains would be secured, however, by a tax collection and wage reporting system distinctly different from the present system, which would need to be administered along side of the present system and would not allow for effective auditing and spot checking. However, it would be possible to reduce non-reporting or erroneous reporting of wages by means of the employer's purchase application forms, by ascertaining whether he is purchasing stamps in amounts corresponding to his payroll. An effective public relations program designed to inform employers and employees of the objectives of the extended program would also have salutary effects.

This plan would place heavy reliance for enforcement upon employees, whose interest in eventual benefits may be insufficient to overcome their resistance to carrying the stamp books, presenting them to employers at the proper time and providing the Social Security Administration with the necessary information to obtain new books. Moreover, employees may prefer to forego eventual old-age insurance benefits rather than disclose information to the Government which would reveal income tax delinquency, or jeopardize their jobs by reporting delinquent employers and reduce the contents of their pay envelopes by the amount of the employee tax. This may be offset by the value placed by employees on insurance against current risks and the protection thus given to their dependents.

Finally, use of the stamp plan would impair the effectiveness of the "work clause", 1/ since an employee desiring to conceal current earnings in excess of the allowable maximum, in order to qualify for benefits, could prevent the posting of wages to his individual account by failing to submit his stamp book to the Social Security Administration. This difficulty would be mitigated to the extent that the Social Security Administration found it practicable to check on those individuals in benefit status, who have failed to apply for stamp books or having received stamp books failed to return them.

C. Selected administrative issues

1. Identification of employer

With respect to the services of employees performed for husband and wife who are living together, some difficulty might be encountered in determining the identity of the employer.

1/ The "work clause" disqualifies for benefit payments any annuitant who during a given month earns more than $14.99 in covered employment. Under the existing system, the Social Security Administration receives regular reports of covered employment which permits enforcement of the "work clause".

While in the ordinary case there would be no question as to the liability of the husband as the principal employer, there might be a number of border-line cases where the service inured solely to the wife's benefit, was outside the category of necessities, and was paid for by the wife out of her own funds. In such cases, it would not be proper to prescribe that the husband is liable as employer.

The possibility of defining "employer" arbitrarily to include both spouses jointly in all of such cases is likewise impractical because it would create a new employing entity separate and distinct from either spouse and would thereby prevent one spouse, who has other employees of his own, from including his domestic or farm employees on the same return.

In the light of these difficulties, it appears that until adequate experience is acquired on this matter the problem might best be solved by way of a ruling (rather than a statute) raising a rebuttable presumption that the husband (living with his wife) is the employer in all cases of agricultural or domestic service performed for either, or both, of them.

2. Identification of employees in agriculture

The eleven-year old problem of determing who are employees would be greatly intensified in the field of agricultural labor which abounds in workers, such as sharecroppers, labor contractors, and heads of family groups, whose classification falls into the twilight zone between the concepts of "employee" and "independent contractor."

Without laboring the characteristics of such workers concerning whom there are relatively little available data, it appears advisable not to attempt at this time to provide any special statutory definition of the term "employee" as applied solely to the field of agriculture. Until more experience is acquired with respect to the coverage of such workers, this problem might best be solved by way of rulings or regulatory presumptions.

3. Payments in kind

A substantial number of domestic and agricultural workers receive part of their remuneration by way of meals, lodging and other perquisites. Such income in kind ought to be included in "wages" for purposes of tax as well as credits under OASI to the same extent that meals, lodging and other perquisites are considered under existing coverage. In other words, no arbitrary table or series of tables should be established either in the Code or Regulations, and values should be determined as at present on the basis of a rebuttable presumption that the employer may use tables of reasonable values established by State agencies for each locality. If State tables are found inadequate, an acceptable alternative would be the use of tables of presumptive values approved by the Bureau of Internal Revenue and the Social Security Administration.

III. PLAN FOR THE COVERAGE OF THE SELF-EMPLOYED

The plan for the inclusion of the self-employed in the old-age insurance program involves a departure from the mechanism now employed in that program, under which employers report the wage records of their employees and make quarterly payments covering both their own tax and the taxes of their employees which are withheld from wages. Because of the inapplicability of the collection-at-source mechanism, the proposed plan relies on the introduction of a self-reporting system. Self-employed persons would be required to file social security tax returns covering their self-employment income and to pay the tax directly to the collectors of internal revenue, very much as taxpayers now file income tax returns. The plan would associate the collection of the social security tax with the income tax.

The degree of coverage under a plan of this sort is a function of the size of the exemption in relation to the levels of income. The higher the exemption, the less the coverage, and vice versa. The determination of the size of the exemption is a policy decision, which should be made in the light of the implications of an exemption of any given size on the cost and other aspects of administration on the one hand, and the degree of coverage on the other. The extent to which complete coverage can be approached is limited only by the Government's readiness to undertake the administrative burdens involved. In the plan here described, the point of departure is the minimum exemption now allowed under the Federal income tax.

The self-employed constitute a heterogeneous group of about 11 million persons. The largest single occupational class is composed of farm operators, representing about half of the total number of self-employed persons. The remainder, the non-agricultural self-employed, are scattered through many industries. Over one-third were concentrated in retail trade, according to the 1940 Census. More than a fifth were in service industries. The professions and the construction industry each accounted for about one-tenth of the urban self-employed.

Among the urban self-employed it is estimated that before the war about 94 percent had a gross income of $500 or more, and about three-fourths had a net income of at least $500. The level of income among the 5.5 million rural self-employed was substantially lower. Over half of the self-employed farm operators, for example, had an output, including products raised for home use, valued at less than $750 in 1939. Many of these farm operators were not entirely dependent on their farm operations. A large proportion worked 100 days or more off the farm; many were over age 65 and probably represented retired farm operators. About 3.7 million persons were wholly or principally dependent on their farm operations. Of these about 1.2 million were in the "poverty" group, each with a gross farm output valued at less than $750. There were only about 50,000 farm operators with a product valued at $10,000 or more.

About two-thirds of the farm operators in 1940 were either part or full owners of their farms. Among those operating as tenants (excluding sharecroppers) nearly half were on a share basis. Independent farm operators were almost entirely men, with a median age of 49.3 years. Over four-fifths of the farm operators were married.

The plan for the coverage of the self-employed described below calls for the imposition of a tax on self-employed individuals measured by selected items of income reported for income tax purposes. It provides for the segregation of that part of total income which is most nearly comparable to wage income and analogous to earned income. Individuals affected, limited to those whose self-employment income for the taxable year exceeds the exemption, would file an annual self-employment tax return and pay a self-employment tax at the same time as they filed their income tax return and paid their income tax. The maximum amount of taxable self-employment income for the year would be $3,000, less such amounts of wages as have been subject to social security tax withholding by the employer. 1/ The base for the proposed self-employment tax would be derived from items of income reported on the income tax return, and this would facilitate appreciably tax administration and taxpayer compliance. Approximation of a tax base as nearly comparable to that employed for wage earners would be achieved by eliminating from the base insofar as practicable those items of income which are clearly unearned, with due consideration for administrative practicability. The Bureau of Internal Revenue would collect the tax and transmit the relevant income information to the Social Security Administration for posting and crediting to the individual's old-age insurance account.

A. The tax base

The key to the definition of the tax base for the purpose of an old-age insurance tax imposed on the self-employed is the isolation of earned income from total self-employment income. This is essential to place the self-employed on a par with recipients of wages. More important, it is essential to the creation of a system of insurance sensitive to the timing of retirement and the amount of the income loss resulting from retirement.

1/ Throughout this section reference is made to taxable self-employment income of $3,000, to accord with the corresponding provision under present law. This study has not considered the case for raising the amount of taxable wages and the reference to $3,000 is not intended to prejudge that issue.

The existing social security program is designed to compensate individuals and their families for the loss of wage income incident to death or retirement. This requires the determination of income from personal services. In the case of wage earners, the determination is generally simple; it corresponds to the contents of the pay envelope. In the case of self-employed persons, however, it presents difficulties because their income is generally a mixture of wages for personal service and of return on invested capital. For purposes of the old-age insurance tax, it is necessary to identify as nearly as possible these two categories of income, to segregate the income attributable to personal services, which presumably stops at death or retirement. In the absence of such a segregation, those self-employed persons whose income includes an element of return from capital which continues after their retirement could either be required to continue to pay contributions and fail to qualify for benefits after they retired or a test of retirement independent of income could be prescribed.

Inasmuch as tax practice has not yet developed an adequate procedure for isolating earned income from investment income applicable to the self-employed, the segregation for old-age insurance purposes must be made arbitrarily. Such segregation can be made by the inclusion and exclusion of broad categories of income received by individuals from particular sources and already reported for income tax purposes. This procedure, described below, provides a reasonably satisfactory working basis for purposes of the old-age insurance tax.

In connection with the coverage of the self-employed, special consideration may have to be given to the scope and application of the work clause. Retirement among the self-employed is a vague concept. Many self-employed persons never actually retire; they work a diminishing number of hours or handle a diminishing number of cases. The practice among lawyers to accept an occasional special case at an age when industrial employment would have prescribed retirement, or the tendency of shopkeepers to continue making token appearances on the premises after they have yielded management to their successors, is illustrative. A related consideration is the practice among wage earners to enter self-employment after being retired as employees. This suggests that a modification of the present work clause is necessary to avoid barring certain self-employed persons from qualifying for benefits even if they were accorded coverage. One such modification might be elimination of the work clause for all persons after they reach age 70.

1. Profits from trade or business

"Profits from trade or business" are now reported as a separate item on the income tax return. Such profits are generally derived in connection with the application of personal services to an enterprise. They are normally "work-connected" and, therefore, should be included in the tax base for the self-employment tax. In the case of those filing income tax returns, this item may be transferred from the income tax return for purposes of the self-employment tax return. The determination of what constitutes a trade or business for purposes of the self-employment tax will raise difficulties in some cases which do not need to be resolved for purposes of the income tax and, as many taxation problems, will have to be settled by administrative decision.

2. Interest, dividend and royalty income

Interest and dividends would be excluded from the proposed tax base because normally they constitute investment income. However, in many cases such items of income are "work-connected" and analogous to the earnings of an ordinary business enterprise, as for example, in the case of small loan operators, security dealers, and pawnbrokers. Moreover, virtually any enterprise may receive interest on its accounts receivable or on notes which it holds. To the extent, therefore, that interest or dividends are trade or business income, provision would be made for including such income in the self-employment tax base.

What has been said of interest and dividend income applies equally to royalty income, and to the extent that such income is derived from a trade or business, it would be included in the self-employment tax base.

The proposed differentiation of interest, dividend and royalty income as between business receipts and personal investment income may be significant in only a relatively few cases. Only when an individual's self-employment income from other sources together with covered wages is less than $3,000 would the distinction come into play. If his income from these other sources amounts to at least $3,000, the maximum tax base, there will be no need for making the allocation because all further amounts of income will automatically fall outside the self-employment tax base.

3. Rents

As in the case of dividend, interest and royalty income, rents are frequently attributable, in varying degrees, to the personal services of the proprietors. Some owners spend considerable time in making repairs and otherwise maintaining and managing their rented property. Accordingly it would seem logical to apply the same treatment to this item of income as is contemplated in the case of dividends, interest and royalties.

Efforts were made to distinguish between that rental income which is predominantly investment income and that which is substantially work-connected. The use of the "trade or business" yardstick, which is adequate in the case of dividends, interest, and royalties, seemed too comprehensive when applied to rents in the light of recent court decisions holding that real estate rentals, even in the case of a single residence, are now considered income from the conduct of a trade or business under the Internal Revenue Code.

The foregoing considerations suggest that the possibility of formulating a practicable rule for the administration of the desired distinction in the case of real estate rents was extremely remote. Of the two remaining alternatives, either to include or to exclude all such rents from the self-employment tax base, the latter appears to be preferable. In the average case, real estate rents are essentially a return on capital which, presumably, will continue after the proprietor's retirement.

It is not clear whether a statutory exclusion of "rentals from real property" would necessarily apply to boarding houses and hotels. It is believed, however, that the receipts in those cases might be properly classified by way of regulations as falling outside the excluded category.

4. Capital gains and annuities

The proposed tax base excludes all capital gains (and losses) since this item is clearly not earned income. This may exclude some items of work-connected income, as in the case of a trader whose profits take the form of capital gains. However, if allowance were made for such exceptions, it would entail complications to a degree deemed highly undesirable. Gains and losses from the sale or exchange of property other than capital assets which is used in the taxpayer's trade or business, also are to be excluded from the tax base. Annuities would be similarly excluded.

5. Net operating losses

With a view to averaging incomes in good and bad years, the income tax allows operating losses sustained in other years to be deducted in arriving at net income. This deduction would not be permitted for social security tax purposes. If the averaging of income achieved by the net-operating loss provision were applied for purposes of the self-employment tax, the self-employed person would be treated inequitably. He would not only fail to receive credit in his social security account for the year in which he sustained the loss, but his credit (and tax) for the year in which he had a profit would also be reduced by virtue of that loss.

To eliminate the net operating loss from self-employment income, the income tax return would be altered. This item would be removed from Schedule C and a new schedule would be inserted on the return to provide for the reporting of the net operating loss deduction.

6. Partnership profits

The rules described above for the inclusion and exclusion of items of income would apply to income derived by an individual from a partnership, syndicate, and joint venture. This would require some changes in the partnership income tax return (Form 1065).

7. Adjustment for taxable wages

In some cases, a self-employed individual may also be employed as a wage earner in an industry covered by the existing old-age insurance program. It would be necessary therefore to provide for an adjustment of self-employment income in order that the total taxable income during the year, including covered wages, did not exceed $3,000. In the absence of such an adjustment, individuals might be taxed on more than $3,000 in any year but receive benefits based on earnings of no more than that amount.

It should be noted that this coordination between the proposed tax on self-employment income and the Federal Insurance Contributions Act is not extended to other Federal retirement programs. Unless some action is taken to prevent duplication, it will be possible for a self-employed person to obtain credit and pay contributions toward railroad retirement benefits or civil service retirement benefits at the same time as he pays tax and obtains credit for his self-employment income. Similar duplication is possible now, however, in the case of wage earners.

B. Exemption from tax

The existing old-age insurance program applies to all wage earners in covered industry regardless of how small their individual wages may be. Under the income tax, the taxpayer is allowed a $500 exemption and a similar exemption for each dependent member of his family. In fitting the proposed old-age insurance plan for the self-employed to the income tax, it would not be appropriate to carry over the present income tax exemptions. If this were done, a large number of self-employed persons would be excluded from the program. The other extreme, covering all self-employed persons no matter how small their self-employment income, would likewise be impractical. Although the present tax on wages for old-age insurance applies to more than 45 million workers, use of the withholding mechanism makes it possible to collect taxes from these people by dealing with only about 2-1/2 million employers. A solution lies somewhere between these two extremes and should be determined by balancing administrative costs and taxpayers' compliance difficulties against the desirability of the broadest possible coverage.

A choice which readily suggests itself is the adoption of a $500 exemption per taxpayer, that is, to exclude from the tax and from coverage those individuals with self-employment income aggregating less than $500 (regardless of the size of their family). It will be recalled that for two years during the war, the normal tax provided for an exemption of this amount. Such a provision would bring under the system an estimated 8.9 million persons in 1947. The principal objection to an exclusion provision of $500 self-employment income is that, as compared with an alternative discussed below, it would exclude approximately 1.6 million persons who are most in need of old-age security. This group consists principally of farm operators, but also includes independent workers in urban areas. The number excluded would vary with the general level of business activity, and in a year such as 1939 might reach 2 million. Another disadvantage of the $500 exclusion is that in a number of cases the self-employment tax will not be collected on self-employment income which will have been reported for income tax purposes. For example, a wage earner with a total income of $2,500 who reports two or three hundred dollars of self-employment income for income tax purposes would not be required to file a self-employment tax return because of the $500 exclusion. While the wage earner will generally be in the social security system, the collection of self-employment tax on his additional earnings, and the additional credit resulting therefrom, would constitute little additional burden to the administrative authorities.

An alternative exclusion might be $200 of self-employment income, with a proviso that the self-employed person must have at least $500 of gross income (i.e., is required to file an income tax return). This would bring under the system an estimated 10.5 million persons. However, in the view of the tax administrative authorities, such an exemption would raise a number of serious problems. It would involve the collection of tax from many individuals who are not liable for income tax because of personal exemptions and credits for dependents, and who characteristically do not file income tax returns, although their income exceeds the amount established as the filing requirement. Enforcement of the self-employment tax on such persons would require additional administrative personnel, at a cost that would be relatively high in relation to the additional taxes collected. The extent of such added costs would vary with the interest of these individuals in acquiring coverage. Although the amount of tax due would be small under the lower exemption, many would be unable to pay it, notwithstanding the Government's efforts to collect it. Finally, it may be noted that the lower exemption would enable individuals who have no self-employment income to acquire coverage at a very low cost merely by reporting $200 of such income. So long as coverage is not complete, there will be an incentive for persons outside the system to report fictitious income. However, as the coverage of the system approaches completeness very few people would need to resort to this device since they would have coverage on the basis of other employment. Although some safeguards may be erected, it would be impractical for the administrative authorities to prevent all reporting of fictitious self-employment income. These considerations also apply to some extent in connection with the higher exemption, but the magnitudes involved would be different.

As stated earlier, the degree of coverage under the social security system is largely a question of administrative costs. Substantial extension of coverage is attainable provided only that additional personnel is made available. However, the determination of the extent of additional coverage is a matter for Congressional determination in the light of administrative cost on the one hand and social and economic desirability on the other.

C. Tax rate

The old-age and survivors insurance program is now financed by a 2 percent tax on wages, one-half imposed on employees and one-half on employers. In the case of the self-employed, there is no employee-employer relationship, and it is necessary to determine whether the tax should be imposed at the employee rate of 1 percent, the combined rate of 2 percent, or at some compromise rate. The decision involves equity and administrative considerations.

Although to date public policy on financing the social security program has not fully crystallized, the Congress has determined, with respect to existing coverage, that 2 percent of covered earnings shall be collected from earmarked taxes. Since the proposed plan of coverage, as indicated at the outset of this report, is based on the assumption that it must fit into the existing social security framework, it follows that the revenue goal of the plan should be 2 percent of self-employment income. If the proposed tax falls short of this goal, it is because considerations other than financing are relevant to the problem.

From an economic and equity viewpoint, it is desirable that social security taxes should not put an employer at an advantage compared with a competing self-employed person. Nor should it alter the balance of factors which determine whether an individual becomes or remains a self-employed person rather than an employee. However, the effects of neither the present social security taxes nor of the proposed self-employment taxes can be assessed with sufficient precision to determine how the relative position of the various groups would be changed by these taxes. The economic effects of social security taxes depend upon the direction and extent of shifting. Given the great variety of prevailing economic relationships, there can be no uniform pattern of shifting of the proposed self-employment tax. Part of the difficulty of determining a tax rate for the self-employed lies in the fact that the self-employed person presumably performs the economic functions of both the employee and the employer. If we compare the self-employed person in his role of businessman with the employer of labor, we are led to the conclusion that he should be subject to the equivalent of the employer tax. And if we compare the self-employed person in his role as worker with an employee, we are led to the conclusion that he should be subject to equivalent of the employee tax. And yet there is a lack of realism in attributing such a dual economic personality to all self-employed persons. Very frequently the economic position of a self-employed person is so much like that of an employee that a distinction between them can be drawn only on the most tenuous grounds. Because of the heterogeneous composition of the self-employed groups, it would seem desirable to levy a tax that is somewhere between the employee rate and the combined employee-employer rate. For example, the rate might be 1 percent on the first $500 or $1,000 or some other specified amount of self-employment income and 2 percent on the balance. 1/

Another equity consideration which tends to support a compromise rate is the fact that the employer tax is a deductible expense for income tax purposes, while the proposed self-employment tax is not to be deductible for income tax purposes. The deductibility of the social security tax insures that the employer, so long as he is subject to income tax, will shift part of the social security tax to the Government, if it is not shifted elsewhere. The self-employed will not have the opportunity to shift part of the cost to the Government in the form of a lower income tax.

D. Other considerations

1. Joint returns

It is contemplated that in the case of a joint income tax return of a husband and wife, a self-employment tax return would be filed only by the spouse having self-employment income. If both spouses had such income, however, each would report self-employment income separately.

2. Community property

At present the salary or wage income of a married couple in a community-property State may not be arbitrarily divided between the two spouses for purposes of the social security tax, although it may be split between them for income tax purposes. Only the spouse earning the salary pays social security tax, and he alone receives credit toward

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1/ If the present tax rates with respect to employment were increased, simultaneous changes in the corresponding rates on self-employment would also be increased.

social security benefits. This principle would also be applied to self-employment income. To depart from it would provide some groups an undue advantage and would distort the pattern of benefit payments now in the law. To adhere to this principle involves some compliance problems. However, the self-employment income to be reported for self-employment tax purposes must normally be determined before any allocation is made between the spouses for income tax.

It does not follow that a husband and wife in a community-property State could not each have self-employment income and acquire eligibility for benefits in his own right. Each spouse may indeed be subject to the self-employment tax because each has self-employment income.

The general rule suggested is that the income from a trade or business shall be treated as the income of the spouse who has the management and control of the trade or business irrespective of State law. If both spouses have the management and control of the trade or business then so much of the income as is attributable to the services or property of each spouse would be treated as the self-employment income of that spouse. This rule would be applied in cases of joint tenancies, tenancies by the entirety, and joint undertakings as well as to community-property income.

3. Partnerships

The "management and control" rule for allocating business income between spouses would not disturb the allocations of income of a genuine husband and wife partnership. Such a partnership, if recognized for income tax purposes, would be valid for social security tax purposes.

4. Accounting periods and methods

Income tax returns are sometimes filed on a fiscal year basis or for part of a year. Consequently, the self-employment tax would also cover periods other than a full calendar year. It would be necessary therefore for the Social Security Administration to make allocations of income, for benefit purposes, to quarters within a calendar year straddled by a fiscal year return. Similarly, it would be necessary for the Social Security Administration to allow for the accumulation on self-employment income credits on the basis of the various accounting methods used in the determination of taxable income under the income tax, such as cash, accrual, percentage of completion, crop, completed contract and instalment basis. Part year returns present a problem in connection with the $3,000 maximum tax base. In order to obviate the possibility that an individual will be taxed in any year on more than $3,000, the limitation would be prorated for part year returns.

5. Exclusion of nonresident citizens, aliens, etc.

It is, of course, possible for nonresidents of the United States to conduct a trade or business here and to derive self-employment income. However, it is not conceived to be the function of the social security program to provide retirement and survivors benefits to such individuals. It is therefore contemplated to exclude from coverage nonresident aliens and persons who are bona fide residents of a foreign country for the entire taxable year. There would also be excluded from the tax base income derived by a United States citizen from sources within a United States possession if such income is not subject to the income tax. 1/

6. Tax decisions to be binding for credit purposes

Since the self-employment tax is to be based upon income reported for income tax purposes, it follows that decisions as to what constitutes taxable income, or on the allowance and disallowance of certain items of deduction, should be equally binding for both taxes.

It is also important that the decisions made for tax purposes should be equally applicable for purposes of crediting an individual's social security account. Otherwise, the Bureau of Internal Revenue may rule one way on say, the deductibility of a given expenditure, while the Social Security Administration may rule another way. Such inconsistency may arise at present in connection with wage earners, because each agency is empowered to place an independent construction on identical statutory language. This is unsatisfactory now, but it would be far worse if a similar situation were to exist with respect to income tax concepts. It is therefore suggested that the Social Security Administration be specifically bound to adopt the decisions made by the Bureau of Internal Revenue with respect to any problem arising under the self-employment tax which might involve an interpretation of the income tax provisions of the Code.

1/ Section 251 of the Internal Revenue Code provides for the exclusion from gross income of all the income derived from sources outside the United States (and not received within the United States) by a citizen who (1) derived at least 80 percent of his gross income from sources within a possession of the United States, and (2) derived at least 50 percent of his gross income from the active conduct of a trade or business within a possession of the United States.

7. Reporting of self-employment tax

As heretofore indicated, the self-employment tax will be computed generally on the basis of data also required for income tax purposes, and it is contemplated that both taxes will be returned to the collector of internal revenue at the same time. The transfer of data from the income tax form to the self-employment tax form and the mechanics of computing the self-employment tax are illustrated by the items and explanations set out in Appendix B.

APPENDIX A

DETAILED COMPARATIVE DESCRIPTION OF PLANS FOR COVERAGE OF AGRICULTURAL AND DOMESTIC EMPLOYEES

1. - MAILING, PRINTING, AND OTHER MECHANICAL OPERATIONS

Plan I Present System	Plan II Book-Return System*	Plan III Stamp System*
A. Publicity and initial applications		
Leaflets will be distributed to all likely agricultural and domestic employers (approximately 10 million) outlining liability of employers under the new law and enclosing post card applications (similar to Form SS-4) for employers' identification numbers.	Same as Plan I	Same as Plan I, except that there would be no employer identification numbers.
All agricultural and domestic employers and employees will be advised by radio and through the press relative to the securing of social security account numbers.	Same as Plan I	Same as Plan I
The employer applications will be preaddressed to the Collectors of Internal Revenue, and will disclose, among other things, the number of agricultural and domestic employees on each employer's pay roll.	Same as Plan I	
On receipt of such applications, the collectors will forward to the employer a sufficient number of applications for employee social security account number (Form SS-5), for distribution to his employees. He will also receive the number assigned to him. (Form SS-6)	Same as Plan I, except that the employee application for an account number would also constitute a request for a wage book.	Same as Plan I, except that the employee application for an account number would also constitute a request for a stamp book.

* Both Plans II and III contemplate that a number of large employers would follow the procedures described in Plan I.

On receipt of the application filed by an employee, the Social Security Administration will send him a card bearing the social security account number assigned to him.	Same as Plan I, except that the employee would also be sent a wage book.	Same as Plan I, except that the employee would also be sent a stamp book.
B. Tax returns		
Toward the close of each calendar quarter a tax return (Form SS-1a), in duplicate, will be mailed by the collector to each employer. On receipt of the tax return from the employer the wage data schedules will be detached by the collectors and transmitted to the Social Security Administration for posting of wage credits to the accounts of the employees listed.	Same as Plan I, but in addition forms would be sent to the employer once a year (and upon request) for use in case an employee does not submit his wage book to the employer.	No provision for quarterly tax returns. Tax will be paid at the time stamps are purchased from post offices and collectors offices. There will be available at these offices special forms to which to attach stamps, in cases where the employee fails to submit his stamp book to the employer.
C. Periodic issuance of books		
No provision	Toward the end of each year, the Social Security Administration will issue a new wage book to each employee. Each book contains a detachable application for a new book, indicating the employee's current address.	Same as Plan II, except that a new stamp book would be issued every six months by the Social Security Administration.

2. - EMPLOYERS' BURDEN

Plan I Present System	Plan II Book-Return System	Plan III Stamp System
A. General procedure		
In addition to computing and withholding the employee's tax and	In addition to computing and withholding the employees' tax and	In addition to computing and withholding the employees' tax and paying

paying a similar tax himself, the employer must (1) apply for an identification number, (2) keep a quarterly record of his employees' names and social security account numbers as well as the wages paid to each, (3) on the basis of such record, fill out a Schedule showing the necessary wage information for each employee, (4) fill out a tax return showing total wages paid and taxes due, and (5) forward the return, the schedule and tax remittance to the collector within the month following the end of the quarter.

paying a similar tax himself, the employer must (1) apply for an identification number, (2) enter on each pay day in every employee's wage book, the amount of wages paid and his initials, (3) enter the amount of wages on a companion slip, removed from the book and retained until the end of the quarter (see p. 35 for specimen page in wage book), (4) fill out a quarterly tax return showing total wages paid during the quarter and taxes due, and (5) forward the return, the wage slips in his possession, and the tax remittance to the collector within the month following the end of the quarter.

a similar tax himself, the employer must (1) requisition and purchase stamps in advance of paying wages, (2) affix the proper number of stamps on the appropriate page of each employee's stamp book every pay day, and (3) cancel each stamp by initialling.

In the case of an employee who does not have an account number, the employer must attach to his return a form showing identifying data relative to such employee.

At least once a year, or at the termination of employment, the employer must furnish each of his employees with a statement showing the total amount of his wages and employee's tax for the period covered by such statement.

Same as Plan I, except that form would also be used if employee failed to present his book to the employer for wage entries.

No provision for receipts other than that represented by employers entry in wage book.

Same as Plan II

No provision for receipt other than that represented by stamps in the employees' book.

(Do not remove this stub) 1

1947 - SOCIAL SECURITY RECORD
OF WAGES RECEIVED BY

JOHN DOEREME

123 45 6789

for quarter ended: Mar. 31 __
June 30 __
Sept. 30 __
Dec. 31 __

Date of Payment	Amount of Wages	Employer's Initials
	$:	
	:	
	:	
	:	
	:	
	:	
	:	
	:	
	:	
	:	
	:	
	:	
	:	
TOTAL	:	

EMPLOYER ....

....
(Identification Number)

(This stub to be removed by employer - See other side) 1

1947 - EMPLOYER REPORT OF WAGES PAID UNDER
FEDERAL INSURANCE CONTRIBUTIONS ACT

JOHN DOEREME

123 45 6789

for quarter ended: Mar. 31 __
June 30 __
Sept. 30 __
Dec. 31 __

Date of Payment	Amount of Wages
	$:
	:
	:
	:
	:
	:
	:
	:
	:
	:
	:
	:
	:
TOTAL	:

I certify that I have paid to the above-named employee the wages shown on this page.

....
(Employer's Name)

....
(Employer's Identification No.)

....
(Address)

For official use only:

B. Special cases

No need for special treatment of any groups.

Employers may, with the consent of the Commissioner, elect to dispense with the use of employee books and to follow the same procedures as under Plan I. Such employers who have commercial and agricultural or domestic employees would include the total wages of both groups in the tax return now required on account of their commercial employees. Attached to the return would be the wage schedule for his commercial employees and the wage slips for agricultural or domestic employees.

Large employers and others, upon application to the Commissioner, would be permitted to include all of their employees in their quarterly returns on Form SS-1a. Such employers will not have to affix any stamps in the books of their agricultural workers but must enter therein at least every six months the total wages paid to such employees during the intervening period.

3. - EMPLOYEES' BURDEN

Plan I
Present System

Employees' only duties will consist of filling out and filing their applications (Form SS-5) for social security account numbers, and of informing employers with respect to such numbers.

Plan II
Book-Return System

In addition to filling out and filing their applications for a wage book and social security account number, employees must remember (1) to carry their wage books with them every pay day, and (2) to present them to their employers for appropriate entries (unless the books are left with the employer), (3) apply for a new book near the end of the year, giving any change of address, (4) sign their old wage books and send them to the Social Security Administration after the close of the year.

Plan III
Stamp System

Same as Plan II, except that new books would be applied for every six months instead of annually.

Plan I	Plan II	Plan III
	In case an employee loses or destroys his wage book or fails to receive a book from the Social Security Administration, he must promptly notify the Social Security Administration thereof.	Same as Plan II
	Whenever an employer fails to make entries in his wage book, the employee must write in the amount of wages, the date of payment, and name of employer, on a page designed for the listing of delinquent employers.	Same as Plan II

4. ENFORCEMENT

Plan I Present System	Plan II Book-Return System	Plan III Stamp System
Enforcement of the employees' and employers' taxes imposed by the Federal Insurance Contributions Act will be undertaken by the Internal Revenue Service and will be primarily dependent upon employer willingness to comply.	Same as Plan I, but in addition, the employee and the Social Security Administration will be in a position to assist in assuring compliance by employers.	Enforcement under this system will depend primarily upon employers' acceptance of the stamp plan, employees' efforts to insure compliance by their employers, and the efficiency of the Social Security Administration in issuing and processing stamp books.
A. Regular contact with employer		
The mailing of Form SS-1a shortly prior to the end of each calendar quarter, will be a reminder to each employer of his recurrent liability.	Same as Plan I	No provision for regular contact with employer.

B. Spot checks and audits		
Agricultural employers who take a deduction for wages in their income tax returns should not present any substantial enforcement problem in view of the disclosures which such employers are required to make in their income tax returns.	Same as Plan I	This system does not lend itself to effective spot checks or audits by the Internal Revenue Service or the Social Security Administration.
In the case of domestic employers, and of farmers who do not file income tax returns, efforts will be made by way of periodic radio broadcasts, spot checks and audits by deputy collectors, and by action on complaints (when practicable) to insure adequate compliance. Assessment lists covering prior periods will be available for such spot checks as may be deemed advisable. The requirement that the employers maintain a record of their pay rolls should assist in the completion of whatever audits are deemed necessary.	Same as Plan I, except that since employers will not be required to keep wage records (other than a copy of the tax return showing total wages), completion of an audit may require securing copies of wage reports from the Social Security Administration, involving delay.	
C. Employee participation		
Employees would be free to remind their employers to withhold the social security tax, to file quarterly tax returns and furnish annual or termination wage statements. In addition they would be free to check on employer compliance by ascertaining from the Social Security Administration the wages credited to their accounts.	Employer entries in wage books each pay day would be a reminder to employers to file quarterly returns, and that such wage books when filed with the Government may disclose noncompliance.	The books presented by employees would be a reminder to employers to obtain the necessary stamps.

Employees' wage books will be examined by the Social Security Administration to ascertain cases of noncompliance. Delinquencies will be checked by the Social Security Administration and, if substantiated, will be referred to the Internal Revenue Service for such action as is deemed practicable (unless, in pursuance of existing policy, enforcement action must be undertaken in each such case).

Employees' failure to return their wage books to the Social Security Administration, and present their books to employers will require some action by the Social Security Administration.

On receipt of complaints regarding employers' noncompliance, the Social Security Administration will conduct preliminary investigations and, in the event of delinquency, will report its findings to the Internal Revenue Service for action. Action by the Internal Revenue Service will depend upon the amount of the deficiency involved, the degree of willfulness, or the likelihood of recurrence.

Same as Plan II; investigations by the Social Security Administration will be particularly necessary in the case of an annuitant.

5. TAXPAYER RESISTANCE AND INERTIA

Plan I
Present System

A. Employers

The failure of housewives and farmers to keep records, the burden of filling in and filing quarterly returns on Form SS-1a, and the average housewife's complete lack of tax experience and tax responsibility, will present difficulties in the enforcement of this system. However, employers who have regular full time employees will have

Plan II
Book-Return System

The remarks about Plan I are fully applicable to Plan II, since Plan II would include the same taxpayers. However, to the extent that Plan II operates to reduce the record keeping requirements of housewives and small farmers, enforcement may be improved. In addition, employees may be expected to assist in enforcement.

Plan III
Stamp System

The remarks about Plans I and II are applicable to Plan III. However, there would be less enforcement pressure from the income tax, because there would be no social security tax return to check against income tax deductions. To the extent that the mechanics of acquiring and affixing stamps is more distasteful than filing returns developed a close relationship with them, and it is unlikely that such employers will resist a system designed to provide OASI to their employees.

Resistance or inertia can be expected from occasional employers. Unlike agricultural employment, the wages paid for domestic service are not deductible for income tax purposes. Hence, domestic employers may feel more free to conceal such wages. The same considerations will also be applicable in the case of the small farmer who does not file income tax returns, and who hires occasional help.

Employers in agriculture include hundreds of large organizations, some already subject to the present reporting system, which keep some record of the wages paid to their workers for purposes of the income tax deduction. Approximately 80% of agricultural workers are employed on only 600,000 farms. While the majority of such workers may be casual or part time employees, the employers occupy a fairly substantial economic status and are unlikely to jeopardize their income tax deductions by failing to comply with the social security tax.

Some housewives may resent having to handle soiled wage books, and farmers may resent making entries in their employees' books under field conditions.

and keeping records, it may engender some resistance not provoked by the other two plans. To the extent that employees fail to present their books, employers will find it difficult to comply.

The small and occasional employer in the agricultural as well as the domestic area may frequently neglect to purchase stamps for his employees' books, and he may never see the employee again. It is doubtful that the employer in such cases will send the stamps in directly to the Social Security Administration.

B. Employees

Many employees may fail to present their wage books to their employers on pay day, or to return them to the Social Security Administration. Such noncompliance will result from (1) negligence, (2) a desire to avoid the withholding of employees' tax and disclosure of income tax liability, and (3) fear that reporting their employer's delinquency might affect their jobs. It does not appear practicable to penalize employees for failure to use their wage books.

The likelihood of employee compliance is extremely difficult to determine. Most of the employees are part time or seasonal workers, and not being required to use their wage books steadily may either lose them or lose sight of their importance. A large number of workers will shift back and forth between employers who are required to make entries in their books and those who are not required to do so, giving rise to loss or disrespect for the books. Failure of an employee to present his wage book for proper entries might encourage some employers to omit such wages from their quarterly returns, a similar result may occur if the employer loses the wage slips detached during the quarter.

All of the considerations discussed under Plan II with respect to the attitude of employees are equally applicable under this system.

Moreover, the possibility of counterfeiting, and the possibility of inflating wage credits by purchasing and cancelling stamps themselves, might give rise to disrespect for revenue laws generally among such employees.

6. CORRECTIONS OF UNDERPAYMENTS

Plan I
Present System

Underpayments could be determined with a fair degree of certainty because the employer would keep records of each employee's wages. The employer may voluntarily correct an underpayment by reporting the additional tax, without interest, as an adjustment on a return filed after the error is ascertained. If not voluntarily reported the additional tax may be assessed and collected under established routines. In either event the collector notifies the Social Security Administration of the exact corrections to be made in the employee's accounts.

Plan II
Book-Return System

Because of the lack of employers' records, underpayments may not easily be determined. If the amount of the error is ascertained, however, an adjustment may be made in the same manner as under Plan I. Form SS-1c also may be used. Employees' books may not be available to employers to an extent sufficient to make them useful for voluntary corrections. Employees' reports of employer noncompliance would have to be screened against posted wage records before action could be taken.

Plan III
Stamp System

Because of the lack of employers' records, and with no routine contact between the employer and the collector, the correction of underpayments will not be convenient. Employers may report additional taxes by obtaining a special form, but there will be no record kept to enable the employer to identify the employee or to report exact amounts of wages and taxes. Employees' reports of noncompliance should be screened against employers' voluntary reports before action is taken.

7. CORRECTIONS OF OVERPAYMENTS

Plan I
Present System

The maintenance of records enables the employer to determine overpayments with a fair degree of certainty. The employer may correct an overpayment by deducting the amount thereof from tax due on a subsequent return. Before making such a deduction of employees' tax the employer must reimburse the

Plan II
Book-Return System

Same as Plan I except that the absence of employers' records will create difficulties in the computation of overpayments and the correction of erroneous wage records. The Social Security Administration will receive numerous requests for photocopies or transcripts of employers' returns.

Plan III
Stamp System

Because of the lack of employers' records, and the fact that the employee's stamp book is the sole device for tax payments, there is no practicable method for correcting overpayments by means of deductions. Accordingly, overpayments can be corrected only by means of refunding procedures.

employee or obtain his written consent to allowance of the deduction. The overpayment also may be corrected by means of a claim for refund filed by the employer or the employee. The collector notifies the Social Security Administration of the exact wage record corrections to be made.

Under this system, the purchaser of unused stamps may obtain cash by filing a claim for redemption with the collector. If the stamps are lost or destroyed, the value of the stamps and proof of loss must be established.

APPENDIX B

ITEMS FOR COMPUTATION AND REPORTING OF SELF-EMPLOYMENT TAX

1. Enter here your net profit or loss from business or profession, including farming, but excluding rentals from real estate. (See paragraphs 1 and 2 of explanation below.)....................................$________
2. If you are a member of a partnership, syndicate, pool or joint venture which had net profit or loss from a business or profession (excluding the rental of real estate), during taxable year, enter here the amount of such profit or loss. (See paragraphs 1 and 3 of explanation below.)................................$________
3. Enter here net total of items 1 and 2. ....$________
4. Enter here wages received by you during the taxable year as an employee on which your employer or employers were required to pay tax under the Federal Contributions Act. (If this amount is $3,000 or more no self-employment tax need be reported.)............$________
5. Subtract amount in item 4 from $3,000 and enter the difference here. (If amount in item 4 is zero enter $3,000.)..$________
6. Enter here the amount in item 3 or item 5, whichever is smaller. (This is your taxable self-employment income.)....................................$________
7. If the amount in item 6 is $1,000 or less enter here 1 percent of such amount. If the amount in item 6 is in excess of $1,000 enter here $10 plus 2 percent of the amount of such excess. (This is your self-employment tax.)....................................$________

EXPLANATION OF FOREGOING ITEMS

1. Husband and Wife.--Regardless of whether husband and wife make a joint income tax return on Form 1040, or reside in a state or territory the law of which treats earnings of husband and wife as community property, each spouse must report separately the amount of self-employment income derived from a business or profession, other than the rental of real estate, carried on by such spouse. If the business or profession is under the management and control of only one spouse, all of the net profits therefrom shall be included in the self-employment income of that spouse. If the business or

profession is under the management and control of both spouses, each spouse must include in his or her self-employment income only that portion of the net profits which is attributable to the services or property of such spouse. In case of a partnership each partner shall report separately in accordance with paragraph 3 below.

2. Rules for Filling in Item 1.--If you are reporting all of your business or professional income in Schedule C of Form 1040 for income tax purposes, the amount to be entered in this item should be the same as that amount (excluding real estate rentals and net operating loss deduction) which you are required to enter in such Schedule C. If you are reporting any business connected royalties in Schedule B of Form 1040 you must include such royalties in the amount to be entered in this item.

3. Rules for Filling in Item 2.--If you were not a member of a partnership, syndicate, pool, or joint venture which realized income from a trade or business during the taxable year, you should enter zero in this item. If you were a member of such an organization, you must enter the amount (excluding real estate rentals) which you are required to report in Schedule E of your income tax Form 1040.

4. Rules for Filling in Item 3.--Enter in this item the net total of items 1 and 2. If amounts in both items 1 and 2 represent profits, the sum of such amounts must be entered here. If the amounts in items 1 and 2 both represent losses, or if a loss in one item is greater than a profit in the other of such items, then you should enter zero in item 3.

5. Rules for Filling in Item 4.--If you received wages during the taxable year as an employee on which your employer or employers were required to pay social security tax under the Federal Insurance Contributions Act (old-age and survivors insurance tax), the entire amount of such wages should be entered in this item, UNLESS such wages amount to $3,000 or more, in which case you are not required to report or pay self-employment tax.

TREASURY DEPARTMENT
Bureau of Internal Revenue
Washington 25, D. C.

FOR RELEASE MORNING NEWSPAPERS,
Thursday, November 27, 1947.

Press Service
No. S-542

George J. Schoeneman, Commissioner of Internal Revenue, today announced the tentative revision, based on recent Supreme Court decisions, of the regulations defining who are employees and are therefore subject to Social Security taxes. The revision deals only with the principles of employment, leaving questions of specific application for later interpretation.

The proposed revision, to be published in the Thursday, November 27 Federal Register, will be held for 30 days to give interested persons opportunity to submit written comments and suggestions, which should be addressed to the Commissioner of Internal Revenue, Washington 25, D. C.

After consideration of those suggestions and actual promulgation of the new regulations, it is contemplated that a number of rulings in various fields of business activity will be published illustrating the application of the principles stated in the new regulations. Among the cases occasioning the revision were United States versus Albert Silk and Harrison versus Greyvan Lines, Inc., holding certain owner-drivers of trucks not to be employees and persons unloading coal from railroad cars into coalyard bins to be employees. Another case, Bartels versus Birmingham, held the leader of a "name band" playing short term engagements at public dance halls was the employer of his orchestra members, and that the dance hall operator, even though the contract provided otherwise, was not the employer. The principles set forth by these Supreme Court decisions indicate broadened coverage among such important groups as life insurance agents, door-to-door salesmen and home-workers.

The Supreme Court in those and related cases has made it plain that determinations of who are employees involve a number of considerations, including:

1. The social purposes of the law.

2. Whether the individual, as a matter of economic reality, is dependent on the business to which he renders service or on his own business.

3. The total situation in the case must be looked to, and no one factor governs.

4. Among factors which are to be used in conjunction with the foregoing principles, are: degree of control over the individual performing services; permanency of relation; integration of the individual's work in the business to which he renders service; skill required; investment by the worker in facilities for work; and opportunities of the worker for profit or loss.

The proposed regulations state the foregoing principles, and would supersede the common law test, also known as the "control" or tort test, used to determine whether a "master and servant" relationship exists.

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TREASURY DEPARTMENT

Washington

FOR RELEASE, MORNING NEWSPAPERS,
Friday, November 28, 1947

Press Service
No. S-543

The Secretary of the Treasury, by this public notice, invites tenders for $1,200,000,000, or thereabouts, of 91-day Treasury bills, for cash and in exchange for Treasury bills maturing December 4, 1947, to be issued on a discount basis under competitive and non-competitive bidding as hereinafter provided. The bills of this series will be dated December 4, 1947, and will mature March 4, 1948, when the face amount will be payable without interest. They will be issued in bearer form only, and in denominations of $1,000, $5,000, $10,000, $100,000 $500,000, and $1,000,000 (maturity value).

Tenders will be received at Federal Reserve Banks and Branches up to the closing hour, two o'clock p.m., Eastern Standard time, Monday, December 1, 1947. Tenders will not be received at the Treasury Department, Washington. Each tender must be for an even multiple of $1,000, and in the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e. g., 99.925. Fractions may not be used. It is urged that tenders be made on the printed forms and forwarded in the special envelopes which will be supplied by Federal Reserve Banks or Branches on application therefor.

Tenders will be received without deposit from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. Tenders from others must be accompanied by payment of 2 percent of the face amount of Treasury bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

Immediately after the closing hour, tenders will be opened at the Federal Reserve Banks and Branches, following which public announcement will be made by the Secretary of the Treasury of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection thereof. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and his action in any such respect shall be final. Subject to these reservations, non-competitive tenders for $200,000 or less without stated price from any one bidder will be accepted in full at the average price (in three decimals) of accepted competitive bids. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank on

December 4, 1947, in cash or other immediately available funds or in a like face amount of Treasury bills maturing December 4, 1947. Cash and exchange tenders will receive equal treatment. Cash adjustments will be made for differences between the par value of maturing bills accepted in exchange and the issue price of the new bills.

The income derived from Treasury bills, whether interest or gain from the sale or other disposition of the bills, shall not have any exemption, as such, and loss from the sale or other disposition of Treasury bills shall not have any special treatment, as such, under the Internal Revenue Code, or laws amendatory or supplementary thereto. The bills shall be subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but shall be exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority. For purposes of taxation the amount of discount at which Treasury bills are originally sold by the United States shall be considered to be interest. Under Sections 42 and 117 (a) (1) of the Internal Revenue Code, as amended by Section 115 of the Revenue Act of 1941, the amount of discount at which bills issued hereunder are sold shall not be considered to accrue until such bills shall be sold, redeemed or otherwise disposed of, and such bills are excluded from consideration as capital assets. Accordingly, the owner of Treasury bills (other than life insurance companies) issued hereunder need include in his income tax return only the difference between the price paid for such bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made, as ordinary gain or loss.

Treasury Department Circular No. 418, as amended, and this notice, prescribe the terms of the Treasury bills and govern the conditions of their issue. Copies of the circular may be obtained from any Federal Reserve Bank or Branch.

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TREASURY DEPARTMENT

Washington

Statement by Secretary Snyder on Inflation Control, before the Joint Committee on the Economic Report.

November 28, 1947

Mr. Chairman and members of the Committee: I appreciate your invitation to appear before this Committee to discuss certain phases of the program for controlling inflation outlined in the President's Message of November 17.

As you know, I appeared before the House Banking and Currency Committee and discussed this subject with them for several hours on Tuesday. Only one business day has intervened since my appearance before that Committee, and the statement that I wish to make before you today, therefore, consists mainly of a restatement of the points that I made before the House Committee.

It is of the utmost importance that we extend early aid to the Western European countries in order to assure that people will not go hungry and cold this winter and to assure their continued participation as free nations in the world economy. It is equally necessary that this aid be extended without subjecting our economy to the strain of further inflation.

Both of these things are essential if we wish to maintain a national environment and a world environment in which peace and freedom can continue to develop. If we fall short of our goal in foreign aid, our own freedom could be threatened by external forces; and, if we fall short of our goal in controlling inflation, we will be threatened by the danger of economic collapse at home. We must avoid both dangers.

I am directing my remarks this morning to one phase of the anti-inflation program. Testimony in support of the emergency program for European assistance has been presented by representatives of the Departments of State, Commerce and Agriculture.

The President outlined three types of measures for the control of inflation; one, measures to relieve monetary pressures; two, measures to channel scarce goods into the most essential uses; and, three, measures to deal directly with specific high prices.

S-544

It is to the first of these measures that I will give attention, as other representatives of the Administration have been invited to discuss items two and three.

Anti-inflationary measures which may be taken in the monetary field are of course but a segment of the whole program, and could not, by any means, solve the problem alone. But such steps as can be taken when related to those in other fields will of course be helpful in the overall solution.

The President is greatly disturbed in regard to price inflation, which threatens our whole economic structure, and he is convinced that the Congress is equally concerned.

The President has laid special emphasis on voluntary actions on the part of businessmen, labor leaders, farmers, and consumers to hold prices down. Intensified efforts will be continued to obtain voluntary restraint. Certain powers are necessary, however, to fortify the voluntary efforts.

The President has suggested that consideration be given to the following monetary measures: one, that Consumer Credit Controls should be restored and some restraint should be placed on inflationary bank credit; two, Legislation should be provided to prevent excessive speculation on the Commodity Exchanges; three, intensified activity in the sale of savings bonds.

The last item is the only one of those suggested which comes completely under the jurisdiction of the Treasury Department, and I shall devote my time principally to a discussion of that particular item. I shall touch but briefly upon the first two as they are primarily the concern of other Government departments and are being discussed by representatives of those departments as they appear and testify.

As to item one, Restoration of Consumer Credit Controls and Restraint on Inflationary Bank Credit, these matters have been discussed by Federal Reserve officials. As to consumer credit controls, I am in favor of their restoration.

The most effective types of credit control are those which strike at the individual forms of credit extension which are contributing to inflationary pressures. The most important single form of such credit extension at the present time is in consumer credit.

Total consumer credit outstanding at the end of September reached an all-time peak of $11,400,000,000. At the end of 1945, it amounted to only $6,600,000,000. Prior to December 1946, total consumer loans outstanding at any one time had never reached the $10,000,000,000 level.

This increased use of consumer credit in the present period of inflationary pressures can only add to those pressures. As we all know, the curtailment of the production of consumer goods during the war period gave rise to a tremendous deferred demand for such goods. As we all know, despite the fact that industrial production during 1947 has reached the highest level ever attained during peacetime, we have not yet been able to produce enough goods to satisfy this deferred demand. There still exist many important shortages of goods. But with production near capacity levels, purchasing power made available by consumer loans can be used only to bid up prices of consumers' goods, not to purchase more goods. It is imperative, therefore, that efforts be made to restrain the demand for scarce goods until supply approaches demand.

Money market interest rates form a small part of the total cost of consumer credit, and changes in such rates are almost powerless to limit its extension. It is necessary to cover specifically by regulation such matters as minimum down payments and the maximum periods over which payments may be spread on installment purchases of consumers' goods in order to restrain this type of inflationary credit.

In reference to the second part of item I "Some restriction should be placed on inflationary bank credit", this is a matter under the jurisdiction of the Board of Governors of the Federal Reserve System which has the responsibility for overall bank credit control. Mr. Eccles has discussed this matter with you in considerable detail. He and I have discussed it together on a number of occasions and we are entirely in agreement that the objective is fundamental to the inflation control program. I do not believe, however, that the specific proposal that he has made will accomplish the objective in question.

I would like to point out that I have a positive feeling that the major objective at this time is to maintain the fiscal soundness of the Government and the continued confidence of the public in Government obligations. I feel that the attack on the problem can best be handled by the application of a substantial budget surplus to the reduction of the public debt in the manner which will extinguish an equivalent amount of bank-held government securities. Since the end of the war, the Treasury has conducted its program of debt management in such a way as to reduce inflationary pressures whenever possible by paying off bank-held securities.

The public debt reached its peak of $280 billion on February 28, 1946. During the following ten months, it was reduced over $20 billion, reflecting the reduction in the cash balance in the Treasury from a wartime to a peacetime level. Almost all of the reduction in the debt during this period took place in the holdings of Government securities by commercial and Federal Reserve Banks. Since the end of 1946, the debt has remained substantially constant, reflecting the approximate balance of the budget during this period. Holdings of Federal debt by commercial and Federal Reserve Banks have nevertheless continued to be reduced and fell by over $6 billion in the first ten months of the year, with holdings by nonbank investors increasing correspondingly.

The concentration of debt reduction during 1946 on securities held by banks and the transfer of over $6 billion of debt thus far in 1947 from bank to nonbank hands have been, in large part, the consequence of the public debt policies of the Treasury and of the restrictive credit policies of the Federal Reserve System. These policies have contributed substantially to the fight against inflation, and will be continued as long as they are appropriate. I should like to note in this connection that a sizable reduction in the public debt will be possible during the early months of 1948 -- during which months will occur most of the excess of Government receipts over Government expenditures predicted for the entire fiscal year.

To minimize bank credit expansion, restrictive measures have been applied to the money market by the Federal Reserve System and the Treasury. This has been reflected by a rise in interest rates and a better balance between short and long term rates.

The average rate on 90 day Treasury bills has increased from 3/8 of 1 percent in early July to nearly 1 percent at the present time; while the rate on 1-year Treasury certificates of indebtedness has risen from 7/8 of 1 percent to 1-1/8 percent in the same period. During this time the yield on the longest-term Treasury bonds -- those issued in the Victory Loan -- has risen from a little over 2.30 percent to about 2.43 percent.

The entire debt management policies of the Treasury since February, 1946 have been of an anti-inflationary character. First, there was the paying off of bank-held Government debt out of excess cash balances; second, there has been a payment on bank-held debt out of funds derived from (a) budget surplus, (b) trust funds, and (c) the sale of savings and investment bonds to the public; third, pressure on the money market with slightly higher interest rates. Through the payment and calling of maturing bonds and refunding them into short term issues, it has been possible to create an interest pressure on the money market without an increase in the net cost of the market debt to the Government.

In making our decisions with respect to public debt management, we must constantly weigh the restrictive effect of any proposed debt management action against its cost in added interest burden on the taxpayer. An increase of 1/2 of 1 percent in the average cost of carrying the public debt, for example, would mean an added burden of $1-1/4 billion a year on the taxpayer.

At the present time, as you know, the interest cost on our public debt amounts to more than $5 billion per annum. This is a large figure and may increase in the future if a larger proportion of our debt is carried in longer-term securities requiring higher coupon rates of interest. It is, therefore, imperative that during these times of great prosperity we should continue to collect adequate revenues over and above a balanced budget to provide for a systematic reduction of the debt total. A reduction in the debt through a substantial budget surplus is the most anti-inflationary measure that can be taken in the fiscal field.

In the field of commercial bank loan credits, the Treasury Department, through the Comptroller of the Currency, has been very active in studying trends and taking steps to induce a restraint in inflationary bank loans.

A few weeks ago, we had the District Chief National Bank Examiners in for a conference, at which time the credit situation was discussed at some length. The Chief Examiners were instructed to have their examiners, during the course of examination of banks, counsel with and caution bankers against speculative lending policies.

More recently, the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Executive Committee of the National Association of Supervisors of State Banks have collectively taken steps to urge the curtailment of all loans either to individuals or businesses for speculation in real estate, commodities, or securities. In a joint statement issued last Tuesday by these agencies all bankers are urged to confine the current extension of bank credit to the greatest extent possible under existing conditions to financing that will help production rather than increasing consumer demand.

Item two: Secretary of Agriculture Anderson has presented testimony to this Committee on legislation that should be provided to prevent excessive speculation on the commodity exchanges.

Item three makes recommendations for the intensification of activity of savings bond sales as an anti-inflationary action.

As the President said in his message of November 17:

"Another effective weapon against inflation is increased savings by the public. Every dollar that is saved instead of spent is a dollar fighting against inflation. In order to encourage additional savings, the Government should intensify its vigorous efforts to sell savings bonds."

Since the war, as an economy measure, the Treasury Department has curtailed enormously the organization of the savings bonds division, and has resorted primarily to those programs for which the voluntary cooperation of individuals and businesses could be recruited. While this procedure has been eminently successful and has produced most satisfactory results in maintaining bond sales in excess of bond redemptions, it still has its limitations.

Up to now the day-to-day efforts of the Treasury savings bond sales organization has been to maintain the popularity of the payroll savings plan among American workers and to sell to the American people the idea of investing regularly for their own good. This program has formed an important part in the Treasury's fiscal policy.

During the war, it was obvious to people why we needed the savings bond program. Everyone could see that the Government needed dollars -- over and above taxes -- to buy munitions and pay wages and subsistence for our armed forces. Each of us had someone -- son, daughter, brother, sister, loved one -- in service and therefore had a direct interest. And, in addition, everyone could understand that savings bonds helped to absorb inflationary dollars which were accumulating at a rapid rate because incomes were growing while goods and services available for purchase were not increasing accordingly due to the fact that war goods were using up materials and labor.

But now that the war is over many people do not understand the importance of the savings bond program today.

The savings bond program absorbs excessive purchasing power in the hands of individuals. This cuts down spending pressures. For this reason, emphasis is being placed -- and will continue to be placed -- on the payroll savings plan for workers and on bond programs for individuals, and especially farmers. The important funds to obtain are the small amounts invested regularly by millions and millions of people. It is the money which is more likely to go on a spending spree that is the most important to get invested in savings. The investor we want most is the individual -- the worker with good income and the farmer whose income is at a high level.

Bond sales of this character are important from a fiscal point of view even if we have a balanced budget, for they widen the ownership of the debt and provide a sounder debt structure. At the same time the sale of these savings bonds makes an important contribution to the control of inflationary pressures.

It withdraws funds in the hands of the individual from the spending stream thus providing funds which enables the Treasury to retire bank held debt. This in turn results in a reduction of the money supply in the economy.

In order to increase the sale of United States Savings Bonds, however, we have an intensive selling job to do.

The Treasury Department is ready to move right away on an enlarged savings bond sales activity. But this increased sales activity will require additional funds over those earmarked for this purpose in the budget for fiscal 1948. We are therefore asking the Congress to give approval to the use of additional funds for the savings bond program over and above those approved in the budget.

The present greatly reduced staff in Washington and in the field can be expanded immediately. With additional personnel and funds for promotion, the number of purchasers on payroll savings plans can be greatly increased and the sales of savings bonds materially multiplied.

Incidentally, I think that you would be interested to know that total sales of savings bonds are continuing to exceed redemptions and the volume outstanding has reached a new high -- nearly $52 billion. In E bonds alone there are $30,894,000,000 outstanding; this volume is today within one-quarter of 1 percent of the peak volume of E bonds outstanding at the close of the Victory Loan nearly two years ago. We have been able, in other words, to increase the savings bond total and to sustain the volume of E bonds outstanding throughout this period of postwar readjustment.

This has been a tremendous accomplishment. There were those, you remember, who predicted that the termination of the war would be followed by wholesale cashing of savings bonds and the liquidation of much of the effect of the wartime savings bond sales effort. The truth is that this just didn't happen. The redemption record of United States Savings Bonds is a cause for considerable gratification for all of us. It is a tribute to the people who sold the bonds during the war and to the people who purchased them. I am confident that with the additional effort that will be provided by additional funds, good results can be obtained.

I have with me today representatives of the Treasury Savings Bonds Division who are prepared to present, with your approval, some interesting statistics in this field.

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TREASURY DEPARTMENT
Washington

FOR RELEASE AFTERNOON PAPERS
Wednesday, December 3, 1947

Press Service
No. S-545

A staff study entitled "The Income Tax Treatment of Pensions and Annuities" was made public by the Treasury Department today. The study is one of the series dealing with various aspects of postwar tax revision. It is factual and analytical in content, and makes no policy recommendations.

Problems of the taxation of pensions and annuities have become increasingly important as the result of lowered personal exemptions and increased tax rates. Because pension and annuity recipients as a group are elderly and retired people whose incomes are for the most part fixed, they have felt keenly the double pressure of higher living costs and wartime tax increases. The study notes that the problems connected with the taxation of pensions and annuities will become more pressing as the proportion of the population receiving pension and annuity benefits increases.

There are now about 2,500,000 Americans receiving annuities, pensions or retirement benefits, not counting veterans' pensions. The number is growing, and will continue to do so as existing retirement programs attain maturity and become fully operative, and as the relative importance of older people in the population rises. The study notes that persons over 65 years of age will increase from the present 7 percent of the population to about $11\frac{1}{2}$ percent by 1980.

A basic step in taxing annuities under the income tax is to segregate that part of the annuity receipt which consists of the repayment of capital or return of the recipient's investment in the annuity, and to apply the tax only to the balance, or to the portion which is income. This income consists of interest earned on the investment, and in the case of employee retirement annuities also includes an element of deferred wages which represents the employer's contribution.

Present law segregates the income portion of an annuity by the use of "3-percent rule" adopted in 1934. Under this rule, the recipient of an annuity payment reports as income for tax purposes a portion of the payment equal to 3 percent of the cost of the annuity. The balance of each annual payment is excluded as repayment of the amount invested in the annuity, until the cumulative amount excluded equals the consideration paid for the annuity. Thereafter, the entire amount of each annuity payment is included in taxable income.

The study points out that the present method for determining the taxable portion of pensions and annuities is unsatisfactory in a number of respects.

The allowance for return of principal, or amount invested in the annuity, may prove inadequate in many cases, notably those of purchasers of annuity contracts under which payments begin immediately. Under such contracts the "3-percent rule" generally overstates the income portion of the annuity. Annuities are written on a yield basis which reflects the trend of investment yields and may in some instances actually result in a yield of less than 3 percent to the annuitant, but more important is the consideration that the 3 percent is based on the original cost of the annuity and so makes no allowance for the declining capital investment resulting from the annuity payments. Thus the annuitant is prevented from recovering his investment tax-free within his normal life expectancy.

A further criticism of the 3-percent rule is that in the case of deferred and employee annuities the exclusions are lumped into the early years and hence may deprive low-income annuitants of tax benefits, due to overlapping of annuity payment exclusions with personal exemptions and deductions. The present method is also criticized because particularly in the case of deferred and employee annuities the present treatment tends to distort the measurement of a taxpayer's ability to pay, because after an annuitant has recovered his principal through yearly exclusions he may be confronted with an abrupt increase in taxable income and tax liability although his annuity payments remain unchanged.

The study examines several alternative methods for correcting the inadequacies of the "3-percent rule" provided under present law. One such alternative is to divide the payments received by annuitants into two parts, principal and income, spreading the exclusion for capital recovery evenly over the period during which payments are received. Another possibility is to modify the present rule by reducing the amount required to be included in taxable income from 3 percent to some lower percentage, say 1 or 1½ percent of the investment. This might be coupled with provision to include a larger portion of the annuity in taxable income, at the option of the annuitant. The third alternative considered would include in the annuitant's taxable income the amount of interest deemed to have been earned on the declining reserve behind his annuity.

The study points out that under present law exemption from income taxes is authorized for certain categories of retirement benefits, such as those provided under the railroad retirement and social security systems, and that this has encouraged proposals for similar treatment of other pension and annuity payments. It observes that inequalities could be eliminated by including social security old-age and survivors' insurance and railroad retirement benefits in taxable income subject to the generally applicable revenue laws. In that event, it might be desirable to prescribe a method for distributing these benefits between income and return of principal, since they consist partly of the return of payroll contributions made by the employees..

The present tax treatment of pensions and annuities involves a number of equity and loophole problems. These include the treatment of lump-sum distributions under retirement plans, single-premium annuities purchased by employers for employees outside qualified employee benefit plans, and interest accruals under deferred annuity contracts.

The comparative treatment of contributory and noncontributory pension arrangements raises broad questions of equity and tax policy which the study discusses.

The present exemption of disability retirement pay of regular Army and Navy personnel favors the recipient of disability pay as against ordinary retirement pay. The study notes that a possible method of obtaining more comparable treatment would be to restrict the exemption accorded such disability retirement pay to the proportion which corresponds to the degree of disability for purposes of civilian employment.

In summary, the study makes clear that opportunities exist for the structural revision of the pension and annuity provisions of the income tax which would make a significant contribution to the development of a sound postwar tax system, and that greater equity could be achieved for the benefit of elderly and retired persons without serious loss of revenue.

Statistical tables accompanying the study present data on pensions and annuities from 1941-44 income tax returns and a variety of other pertinent information. The tax treatment of pensions and annuities under Canadian law is described.

THE INCOME TAX TREATMENT OF PENSIONS AND ANNUITIES

Division of Tax Research, Treasury Department
December 1947

The Income Tax Treatment of Pensions and Annuities

One of the areas in the Federal individual income tax which calls for reexamination in connection with general tax revision is the treatment of pensions and annuities. The problems in this area have become increasingly important as a result of wartime reductions in the personal exemptions and increases in tax rates, and the increases in the cost of living. They will continue to grow in importance as the proportion of the population participating in pension and annuity plans increases.

This study examines those phases of the pension and annuity provisions of the revenue laws which have been criticized, and considers alternative methods of revision. It contains no policy recommendations and is confined to providing factual and analytic background material to assist in the formulation of such recommendations.

This study was prepared in the Individual Income Tax Section of the Division of Tax Research. The revenue estimates were supplied by the Office of the Technical Staff. Valuable assistance and suggestions were received from other members of the Treasury staff, including the Government Actuary on actuarial matters, the Office of Tax Legislative Counsel on legal matters, and the Bureau of Internal Revenue on administrative matters.

Division of Tax Research
U.S. Treasury Department

The Income Tax Treatment of Pensions and Annuities

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SUMMARY

In recent years a number of criticisms have been directed at the provisions of the individual income tax which govern the tax treatment of pensions and annuities. These provisions directly affect millions of elderly and retired people currently receiving pension and annuity incomes and have prospective importance to all employed persons, annuity investors, or their families, who at some future time will become beneficiaries of pension and annuity payments.

Excluding recipients of veterans' pensions, approximately 2,500,000 Americans are now receiving annuities, pensions, or retirement benefits. In 1944, the last year for which final data are available, more than 250,000 persons filed Federal income tax returns reporting pension and annuity incomes derived from life insurance policies, individual purchases of annuity contracts, and private or public retirement benefit plans. The relatively low level of most annuity payments and the authorized exclusion from taxable income of certain types of retirement benefits, as well as the reporting of some pensions and annuities as wages or salaries, are factors which combine to reduce the number of persons reporting annuities under the income tax. The number of pension and annuity recipients is growing and will continue to increase as existing retirement programs attain maturity and become fully operative, and as the relative importance of older people in the population rises. About 7 percent of the population is now over 65 years of age, and, with present trends, this percentage is expected to increase to about $11\frac{1}{2}$ percent by 1980.

A characteristic feature of pension and annuity recipients as a group is that they are elderly and retired people whose incomes are for the most part fixed. As a result, they have felt more keenly than others the double pressure of higher living costs and wartime tax increases.

Annuities received by individuals consist in part of the return of principal (the amount invested in the annuity) and in part of income. The problem in taxing annuities under the income tax is to segregate that part of the annuity receipt consisting of the repayment of capital (the return of principal) and to subject to taxation only the balance, that portion which consists of income. Such income consists of interest earned on the investment and, in the case of employee retirement annuities, also includes an element of deferred wages. Existing law seeks to provide for the tax-free recovery of the annuitant's capital or investment by the application of the so-called 3-percent rule adopted in 1934. This rule prescribes the inclusion of 3 percent of the cost of the annuity in the recipient's taxable income each year. The balance of each annual payment is excluded from income for tax purposes until the cumulative amount

excluded equals the consideration paid for the annuity. Thereafter, the entire amount of each annuity payment is included in taxable income. This formula for segregating income from capital has been unsatisfactory in a number of respects.

As to immediate annuities, the principal difficulty is that the 3-percent rule applied to original cost makes no allowance for the declining capital investment resulting from annuity payments. In the case of contributory employee annuities and deferred annuities (which become effective only after some period of time, usually the premium payment period, has elapsed following purchase), the exclusion from taxation of annuity receipts in excess of 3 percent of the annuitant's cost generally provides adequate tax-free recovery of the consideration paid for the annuity for the person who lives out his normal life expectancy. Even in such cases, however, the 3-percent rule tends to "bunch" exclusions for capital recovery in a few early years, after which the full amount of each annuity payment is taxable as income. In the process of this "bunching" of exclusions for the recovery of capital, many low-income annuitants are deprived of tax benefits because their allowable exclusions are wasted, due to overlapping of such exclusions with personal exemptions and deductions. If taxable income and tax-free return of capital were more evenly distributed over the years, annuitants would be able to make fuller use of their exclusions as well as the personal exemptions and deductions allowed under the income tax.

A further criticism of the 3-percent rule is that even where it allows adequate tax-free recovery of capital with full tax benefit, it results in an artificial variation in taxable income which tends to distort the measurement of the taxpayer's ability to pay. Thus, when the elderly annuitant has recovered his principal through yearly exclusions, he is confronted with an abrupt increase in taxable income and tax liability although his annuity receipts remain unchanged.

The 3-percent rule has been criticized also for its treatment of the losses of short-lived annuitants (sometimes termed mortality losses under annuity contracts). Although it requires the annuitant to report a part of his receipts as taxable income before his capital is recovered, no adjustment is made in case he dies prematurely, notwithstanding the fact that part or all of the income subjected to taxation during his lifetime turns out to have been only return of capital.

The present study examines several alternative methods for correcting the inadequacies of the 3-percent rule. One such alternative is to divide each annual payment into two parts, principal and income, spreading the exclusion for capital recovery evenly over the period during which payments are received. In general, under this method the element of principal would be computed by dividing the cost of the annuity by the number of years payments were expected to continue. For example, in the case of a single-life annuity, this period would be the annuitant's life expectancy at the time payments began, as determined by a mortality table. This method would raise the question of the selection of appropriate mortality tables.

If this procedure were followed, annuitants as a group would include in taxable income the true income element in their annuity receipts provided that their lives approximated the specified life expectancies. Allowance would not be made for individual deviations from normal life expectancy. Favorable treatment of individual mortality gains realized by those who chanced to live beyond their normal life expectancy would be balanced against the disallowance of mortality losses incurred by short-lived annuitants. The salient feature of this plan is that the annuitant would include a constant portion of his receipts in his taxable income as long as he lived, with the result that the wastage of capital recovery exclusions would be avoided. Moreover, there would be no abrupt increase in his taxable income after capital is recovered, such as occurs under present law.

An alternative method for meeting the criticism leveled against the 3-percent rule is (a) to reduce the amount required to be included in taxable income to some lower percentage, say 1 or $1\frac{1}{2}$ percent of the annuitant's cost (which would correspondingly increase the amount excluded as tax-free return of capital), and (b) to allow the annuitant the option of including a larger share of his receipts in taxable income in order to avoid his wasting the exclusion for return of capital. In order to avoid return of capital being taxed as income, a deduction from income might be provided for losses incurred by annuitants who die before recovering their cost free of tax. This method would meet some of the major objections to the present law. However, it would not entirely remove the problem of an abrupt increase in the taxable portion of the annuity at the end of the period of capital recovery. Moreover, the benefits of a deduction for losses incurred by short-lived annuitants would accrue to their estates or survivors and would provide no relief to annuitants during their own lifetime.

Another alternative to the 3-percent rule would be to impute to the annuitant each year an amount of income equal to the interest earned on the reserve behind his annuity. The amount so imputed would then be included in the annuitant's taxable income. This would have the effect of treating annuity payments like withdrawals from a bank account, consisting partly of income in the form of interest and partly of principal. Under this procedure the taxable portion of annuity income would be relatively large during the early years when reserves were high and would decrease as the annuitant grew older and the reserve behind his annuity diminished. Short-lived annuitants would pay more tax under this method than under the other alternatives, while long-lived annuitants would be treated more favorably since payments would be largely exempt as the reserves behind their annuities and the income attributed to those reserves dropped to a very low figure. This would accentuate the problem of the treatment of losses suffered by short-lived annuitants. Moreover, the so-called reserve-earnings method would involve formidable administrative tasks in making the actuarial analysis necessary to calculate the reserve earnings of various types of annuities.

At present, special categories of retirement benefits, such as those provided under the railroad retirement and social security systems, are exempt from tax. This precedent has served to encourage proposals for similar treatment of other pension and annuity payments. The question of special exemptions for pension and annuity incomes is related to the proposals for special treatment of elderly persons.

The inequalities growing out of the preferential treatment accorded special categories of pensioners could be eliminated by making social security old-age and survivors' insurance and railroad retirement benefits subject to the generally applicable revenue laws. This would raise the question of the proper distribution of these benefits between income and capital, since they consist partly of the return of employee payroll contributions. The problem could be handled in any one of several ways, each centered on the concept that social security and railroad retirement benefits are in effect annuities purchased in part by the employee's payroll tax contributions and their beneficiaries should therefore be accorded an opportunity to recover their payroll contributions tax-free.

Another approach would be to allow the employee to deduct or exclude his payroll tax contributions from his current taxable income and to subject all of his retirement benefits to taxation when they are received. This would involve not only a postponement of revenue but a net revenue loss as well, since the revenue decrease due to the current deduction of payroll tax contributions from employee's earnings would normally exceed the revenue gain which would result from his ultimate inclusion of benefit payments in taxable income. Moreover, this procedure might serve as a precedent for similar treatment of employee contributions under private and public retirement pension plans and of savings of self-employed persons devoted to the purchase of endowment policies and annuities which would involve a radical departure from existing concepts of income and would entail serious revenue consequences.

The present tax treatment of pensions and annuities involves a number of equity and loophole problems. One of these concerns the treatment of lump-sum distributions under retirement plans. Under certain conditions lump-sum distributions from trusteed plans (where the assets of the plan are segregated and invested through a trust) are accorded long-term capital gains tax treatment (such gains are included in taxable income to the extent of 50 percent and subject to a maximum effective rate of 25 percent). Whatever the merit of capital gains treatment in such circumstances, similar distributions under non-trusteed plans may appear to have equal claim for favorable treatment. An alternative to capital gains treatment would be the adoption of some averaging device designed to mitigate the impact of progressive rates on relatively large lump-sum payments but without unduly impairing the progression of the income tax.

Another problem is raised in connection with the tax treatment of a single-premium annuity purchased by an employer for an employee outside a qualified employee benefit plan (one which meets certain statutory standards of non-discrimination and reasonableness as a condition for favorable tax treatment). Under present law, the value of such contracts is included in the employee's income in the year of purchase. When annuity payments are received, they are subject to the 3-percent annuity rule which enables the employee to recover tax-free the consideration which has already been included in his taxable income. Proposals have been made to allow the employee to exclude from taxable income the value of the contract when vested and to include the full amount of annuity payments in his taxable income when received. Such proposals, however, would tend to set aside existing sanctions against unqualified employee benefit plans (which do not meet statutory tests of non-discrimination and reasonableness) and seriously impair the safeguards against tax avoidance under present retirement-plan provisions. Some, but by no means all, phases of tax avoidance under such proposals might be lessened through a modification designed to spread the employer's deduction of the cost of such contract over the years the annuity is paid and taxed to the employee.

Installment payments of life insurance proceeds by reason of the death of the insured are now entirely exempt, including the element of interest accruing after the death of the insured. If it is desired to include such interest in taxable income in order to treat it on a par with annuities or other investments by survivors, such life insurance installment payment might be taxed as an annuity, the cost of which was the lump-sum or commuted value at the time of the death of the insured.

Deferred annuity contracts may involve opportunities for substantial tax avoidance through postponement of realization of investment earnings. It might be possible to meet avoidance problems in this field by limiting the amount of interest accruals under these contracts allowed to be currently excluded from taxable income.

The comparative treatment of contributory and noncontributory pension arrangements raises broad questions of equity and tax policy. The current exclusion from the employee's taxable income of the employer's contribution under qualified plans confers important tax advantages on recipients of employer-financed benefits. This treatment, particularly during the war period, has tended to encourage the development of plans on a noncontributory basis. It has been proposed to provide comparable treatment for employer- and employee-financed benefits by allowing employees currently to deduct their retirement contributions from taxable income. As already noted, this type of proposal would significantly modify the definition of taxable income as it relates to the treatment of savings. Moreover, it would raise questions pertaining to the averaging of income for tax purposes and the special treatment of earned income.

The present exemption of disability retirement pay of regular Army and Navy personnel favors the recipient of disability pay as against ordinary retirement pay. More comparable treatment might be obtained by restricting the exemption of disability retirement pay to the proportion which represents the degree of disability for purposes of civilian employment.

While this study makes no specific policy recommendations, it makes it clear that opportunities exist for the structural revision of the pension and annuity provisions of the income tax which would make a significant contribution to the development of a sound postwar tax system. The advantages of greater equity in the income tax structure as it applies to elderly and retired persons might be achieved without serious loss of revenue. The technical and actuarial problems and issues encountered in revising the tax treatment of pensions and annuities are formidable. This, however, need not preclude the formulation of a more equitable and satisfactory tax structure as it applies to this increasingly important group of the population.

The Income Tax Treatment of Pensions and Annuities

I. Introduction

This study examines a number of income tax problems pertaining to pensions and annuities under present law, 1/ and analyzes some alternative methods for their solution. Attention is focused primarily on the treatment of pension and annuity benefits from the viewpoint of individual recipients. The problems of employers are only incidentally considered. 2/

Because of the close relationship between life insurance and annuity contracts, particularly in the case of deferred annuities and refund and survivor benefits, 3/ it is difficult to treat matters relating to pension and annuity taxation separately from the tax provisions applicable to life insurance. Nonetheless, this study makes no attempt to examine fully the issues raised by the relatively favorable tax treatment of life insurance.

The existing tax provisions applicable to pensions and annuities have been developed in piecemeal fashion. Since the Thirties, under the stress of sharply lowered individual income tax exemptions and increased tax rates, imperfections in the present treatment of pensions and annuities have become more evident. Pensioners as a group have relatively fixed incomes, subject to the double pressure of higher living costs and increased taxes. Moreover, retirement incomes are typically much lower than the previous earnings they succeed. This ordinarily involves careful planning and adjustment of the annuitant's mode of living. The difficulties of adjustment are enhanced where unforeseen tax and living cost increases substantially upset calculations with regard to minimum retirement needs. Pensioners and annuitants as a group are elderly and in many instances suffer various disabilities which may necessitate higher living expenses. These disabilities make it difficult or impossible to make personal adjustments to higher taxes and prices by accepting employment or by retrenching.

The income tax treatment of pensions and annuities is also growing in importance because pensioners and annuitants constitute an increasing proportion of the population. This increase is due chiefly to the development of public and private pension programs. While there has already been an increase in total current payments under these plans, there is a still greater potential increase as existing plans attain maturity. Even without further extension of the coverage of these programs, a large proportion of all income earners and their families will at some time in their lives be pensioners or annuitants.

1/ Unless otherwise indicated, all references to "present law" and to specific sections pertain to the Internal Revenue Code, as amended by the Revenue Act of 1945.

2/ This study does not consider various questions relating to the income tax treatment of pension, profit-sharing, and stock-bonus plans at the employer level under Secs. 165 and 23(p).

3/ An explanation of technical terms is contained in Appendix D.

Another reason accounting for the relative increase in pensioners and annuitants as compared with other types of income recipients is the shift in the age structure of the population involving a higher proportion of older persons. 1/ Increased urbanization and industrialization have necessarily brought under organized retirement pension programs persons who would have relied, as independent farmers, artisans and business people, on their personal savings and investments for retirement needs. Annuities are a form of insurance which provide a logical method of ensuring lifetime security, combining an orderly use of principal with the safety and convenience of institutional investment. Consequently, the decline in interest rates probably tends to increase the purchase of annuities, since more retired persons tend to consume their capital at a faster rate. To some extent, the income tax advantages of deferred annuities, including those arising under life insurance and endowment contracts, appear to be a factor encouraging the purchase of annuities. 2/ During the period of the great depression annuities were attractive not only for reasons of investment security, but also because of the advantages of a fixed income under declining prices.

The problems in the field of taxation of pensions and annuities fall into several broad categories:

a. One problem arises in connection with the segregation of the income and capital elements of annuity payments. A satisfactory determination of the portion of annuities to be included in income for tax purposes and the portion to be excluded as tax-free return of capital has long been a source of difficulty in this and other countries. 3/

1/ At the present time, about 7 percent of the population is over 65 years of age. According to Bureau of Census estimates, assuming medium mortality and fertility and no net immigration, this percentage will increase to about 11-1/2 percent by 1980. See Forecasts of the Population of the United States, by Age and Sex: 1945 to 2000, Population - Special Reports, Series P-46, No. 7, September 15, 1946, Bureau of the Census, U. S. Department of Commerce.

2/ On the other hand certain apparent tax disadvantages, particularly as regards estate and gift taxes, may discourage such purchase, chiefly where survivor benefits are a factor.

3/ Under British income tax life annuities are taxable in full as income, with no allowance for return of capital. However, annuities certain (payable for a fixed term of years) and some other types of annuity contracts are taxable only with respect to the interest element. For a recent discussion of the problems raised by the British income tax treatment of annuities, see "Annuities and Taxation," The Economist, February 8, 1947, pp. 250-252. The Canadian experience with the taxation of pension and annuity income culminated in a survey in 1945 by a Royal Commission whose recommendations were adopted under Canadian legislation in 1945 and 1946. The Commission's Report is summarized in Appendix B.

b. There are inequalities in the treatment of different annuitant groups due to special exemptions for certain types of pension payments which, in turn, have raised the issue of extending similar special treatment for other groups.

c. A third problem concerns the tax treatment of lump-sum retirement benefits which may have accrued over a period of years. Such lump sums are subject to taxation either as ordinary income or as long-term capital gains.

d. A fourth group involves a miscellany of loophole and equity issues. These include: (1) the postponement of tax on interest accruing under deferred annuity contracts, (2) the exemption of interest accruing after the death of the insured on annuities payable under life insurance contracts, (3) the tax treatment accorded benefits under contributory as compared with noncontributory employee pension plans, and (4) the tax treatment of deferred annuities under so-called key executive employment contracts.

e. Since most annuitants are elderly people, the tax treatment of pension and annuity income is also related to proposals for special income tax treatment of elderly persons.

The analysis of these problems and of the alternative solutions possible, makes it apparent that opportunities exist for structural revision in the pension and annuity provisions which would make a significant contribution towards the development of a sound postwar tax system. In general, the major criteria for satisfactory pension and annuity provisions are the same as for other phases of income taxation, namely, correct measurement of income, uniformity of treatment among similarly situated persons, and administrative feasibility. The equity advantages which would derive from effective adjustment in the pension and annuity field overshadow the relatively small amounts of revenue directly involved. The technical and actuarial problems and issues encountered in the task of formulating a sounder approach to the tax treatment of pensions and annuities are formidable. These account for the difficulties which have characteristically beset taxing authorities in their attempts to deal with this type of income. Nevertheless, desirable changes in this increasingly important area might go a long way in providing a more equitable and satisfactory tax structure as it applies to millions of elderly and retired persons receiving pensions and annuities.

II. Amounts and numbers of taxpayers involved

A. Statistics of Income data 1/

Annuity and pension income is a relatively small part, about one-fifth of one percent of total income reported for income tax purposes. There were roughly 260,000 recipients of taxable annuities filing income tax returns in 1944. 2/ According to the 1944 data, the average annuity or pension reported on income tax returns was about $700, with almost one-fifth of the annuities and pensions falling below $100, over half under $500, another one-quarter between $500 and $1,000, and only about 3 percent being as much as $2,000 or more. 3/

The percentage of returns reporting annuity income increases with size of income. 4/ However, annuity income constitutes a larger percentage of total income at the lower than at the higher income levels. 5/ The average size of annuity income increases with the size of income, but not proportionately. 6/

1/ The statistics are shown in Appendix A. Prior to 1941 annuity income was not tabulated separately in Statistics of Income, being included with various items in "Other income." Data from 1941 tabulations are adapted in Tables 1 to 3. Statistics of Income for 1942 shows amounts but not frequencies of annuity income. The 1942 data are adapted in Table 4. Annuities data from final statistics of 1943 individual income and Victory tax returns are shown in Table 5. Press releases dated June 25, and August 21, 1947, Press service Nos. S-366 and S-436 provide information on the frequency and amounts of annuity and pension income distributed by adjusted gross income classes. This information is shown in Table 6. A special tabulation on income tax returns for 1944 provides information on the frequency of annuity and pension income recipients distributed by the size of the annuity and pension income. This information is shown in Table 7.

2/ Press release dated August 21, 1947 (Press service No. S-436) for Statistics of Income for 1944, Part 1, Table 2.

3/ See Tables 6 and 7.

4/ See Tables 1 and 6.

5/ Thus, in 1942, annuity income constituted .22 percent of total income on Form 1040 returns with net income under $5,000 and only .08 percent of total income on returns with net income of $300,000 and over. See Table 4. For other years, see Tables 1, 2, 5 and 6.

6/ To illustrate, in 1941 the average annuity item was $936 for returns with net income between $5,000 and $10,000, and $9,826 for returns with net income of $300,000 and above. For a more detailed breakdown of the 1941 annuity data by size of net income, see Table 2. In 1944, the average pension or annuity was $388 for taxable returns with adjusted gross income between $500 and $750 and $7,964 for returns with adjusted gross income above $300,000. See Table 6.

The geographical distribution of pension and annuity income shows that residents of certain States, notably California, Colorado, Florida, and the District of Columbia, have relatively large amounts of annuity income as compared with other types of income. 1/

In addition to its relatively heavy distribution in the lower part of the income scale, the amount of pension and annuity income reported on tax returns appears not to have changed significantly during the period 1941-1944 when other types of income have increased. 2/

B. Other data on pension and annuity income and recipients

1. Exempt groups

Important groups of pension recipients are not represented in the income tax statistics because their pensions are excludible from gross income. The latest available information regarding the number of such pension and annuity recipients, and average and total amounts of pension and annuity payments, is shown in Table 8. About 1,708,800 individuals are currently receiving pensions under the old-age and survivor benefit provisions of the Social Secruity Act. The average annual payment is now about $228 per individual, total annual payments being approximately $390 million.

Under existing law, a retired worker under social security old-age and survivors' insurance receives a minimum annual pension of $120. As of 1947, the maximum annual benefit for a single person with no dependents is $528. For a married person, the maximum benefit is $792. 3/ The maximum annual benefit for a widow with three or more minor children is $1,020, representing the highest annual pension payable under present law. 4/

1/ California returns for 1941, for example, had 7.6 percent of the total income in all States but 13.8 percent of the total annuity income. See Table 3.
2/ The total amount of pension and annuity income was about $164 million in 1941, not including Form 1040A returns, and about $181 million in 1944.
3/ If both husband and wife are eligible workers who retired at the end of 1946, their combined maximum benefits are $1,056.
4/ For later years these maximums (other than the $1020 over-all ceiling) will increase, depending upon the number of years elapsed since 1936. More detailed information regarding social security old-age and survivors' insurance benefit levels is shown in Appendix C.

As social security benefits are in all cases less, and generally substantially less, than the existing personal exemptions, a recipient of social security old-age and survivors' insurance pension would not be subject to Federal individual income tax even if his pension were included in gross income, unless he had other income. 1/

The other major exempt groups, outside of veterans and their families, are the 199,400 individuals now receiving pensions under the Railroad Retirement Act, whose average annual pension is $846, totaling about $167 million annually.

A retired worker under present railroad retirement provisions receives an annual pension which may range from a maximum of $1,440 down to indefinitely small amounts, depending upon length of service. 2/ The retirement allowance is not related to the number of dependents supported by the beneficiary. Survivorship benefits are also provided, varying with size of family. For a widow the annual payments range to a maximum of $470, as of 1947. In the case of a widow with three or more children eligible for benefits, the maximum annual benefit would at present be $1,254, representing the highest annual family benefit payable. 3/

A substantial percentage of retired inactive Army and Navy personnel are retired on account of physical disability and their retired pay is exempt (see Section 3 below). In addition, there are comparatively minor groups receiving pensions partially or wholly exempt as gratuities, such as beneficiaries of the Carnegie Foundation teachers' retirement plan and of the International Typographical Union Pension Fund. 4/

1/ A possible exception would occur in the case of a widow with one or more dependent children receiving benefits up to $1,020, where the children each had $500 or more gross income and were consequently disallowed as dependents for income tax purposes.

2/ If railroad retirement payments were includible in taxable income, many of the retired workers would be taxable.

3/ For later years these maximums (other than the $1440 over-all ceiling) will increase, depending upon the number of years elapsed since 1936. For more detailed information regarding railroad retirement benefit levels, see Appendix C.

4/ In 1946, it was reported that the International Typographical Union Pension Fund had 6,648 pensioners on its rolls; individual pensions were at the rate of $10 a week, or $520 a year; total pension payments to union members in the United States and Canada amounted to $3,447,128 in 1945. See Tax Exemption of Annuity Payments under Civil Service Retirement, Hearing before the Committee on Finance, U.S. Senate, 79th Cong., 2nd Sess., on H.R. 2948, February 28, 1946, p. 30.

2. Taxable groups

In 1945 about 85,000 retired Federal Civil Service employees were on the pension rolls, the average pension being about $970. Retired State and local government employees numbered about 208,000 in 1945, their pensions averaging about $850. In addition, about 560,000 annuitants were reported by life insurance companies in 1945, the average annuity being about $360. No reliable figure is available for the number of pensioners receiving payments under industrial retirement plans of various types. 1/

Less than 900 or 1 percent of some 85,000 Federal Civil Service annuitants have annuities in excess of $2,000 annually. 2/ By far the most numerous size of such annuities is $1,200 annually, which is the exact amount received by about one-third of the Federal Civil Service annuitants. About three-fifths of all Federal Civil Service annuities are less than this amount. 3/

3. Retired inactive Army and Navy personnel

The available information relating to numbers of retired inactive military personnel and the amounts of their retired pay, based on estimates for the fiscal year 1947, are summarized in the following table:

1/ See Table 8. It should be noted that to the extent governmental or private industrial pension plans involve group contracts with life insurance companies, industrial retirement plan annuities would be included in the insurance company figures.

2/ It is thus apparent that exemption from taxation of the first $1,440 of annuity or pension income combined with the present exemption levels approximating $550 for single persons and $1,125 for married couples under the Form 1040 tax table would eliminate from taxable income virtually all Federal Civil Service retirement income.

3/ The distribution of Federal Civil Service retirement annuities by size classes, as of the end of the fiscal year 1945, is shown in Table 9.

Number of retired inactive Army and Navy personnel and amounts of retired pay, revised estimates for fiscal 1947

	Number	Amount (in millions)	Average	Retired on account of disability: Number	Retired on account of disability: Percentage of retired
Army					
Officers	6,189	$ 23.3	$ 3,762	4,045	65%
Warrant officers	967	2.0	2,086	388	40
Nurses	1,892	3.1	1,645	1,854	98
Enlisted men	19,000	32.1	1,692	7,500	39
Total	28,048	60.6	2,159	13,787	49
Navy					
Officers	9,351	34.80	3,722	7,500 a/	80 a/
Enlisted men	15,742	22.64	1,438	n. a.	n. a.
Fleet reserve, 16- and 20-year men	14,190	22.65	1,596	n. a.	n. a.
Nurses	425	.86	2,034	400 a/	90 a/
Reserve officers	5	.02	3,033	n. a.	n. a.
Reserve enlisted men	44	.06	1,434	n. a.	n. a.
Total	39,757	81.03	2,038	7,900 b/	81 b/
Total Army and Navy personnel	67,805	141.6	2,088	21,687 b/	57 b/

a/ Preliminary rough estimate.
b/ Excludes all Navy enlisted men and Navy reserve personnel.

Sources: Hearings before the Subcommittee of the Committee on Appropriations, House of Representatives, 80th Cong., 1st Sess., on First Deficiency Appropriation Bill for 1947, pp. 368, 370, 372; Budget of the United States Government for the fiscal year 1948, p. 651; and information supplied by the War and Navy Departments.

n. a. Not available.

The data for fiscal year 1947 indicate about 68,000 retired inactive Army and Navy personnel receiving retired pay totaling $142 million annually. The average annual payment per individual in this group amounts to about $2,100.

Of the total number of military personnel receiving retired pay, about 15,500 are commissioned officers, receiving average annual payments of about $3,750 per individual. In the retired officer group, from 65 to 80 percent are retired on account of disability, and their benefits are therefore exempt. 1/ A very high proportion of retired Army and Navy nurses are also in the disabled group. It appears that less than one-half of the retired noncommissioned officers and enlisted personnel in the Army are on the retired list because of disability. Comparable information for the Navy is not available.

C. Future magnitudes

As social security and various other pension programs attain maturity under existing coverage and benefit provisions, the number of individuals and amounts of income affected will increase. Consequently, it is necessary to consider not only the amounts and numbers of individuals involved in current pension and annuity payments but also the prospective future magnitudes. A full discussion of future trends in the pension and annuity field is outside the scope of this study. However, the growth factor in existing programs is illustrated in the following table which summarizes some available data with respect to the social security old-age and survivors' insurance and railroad retirement programs. Increases in coverage and the level of benefit payments would increase the magnitudes indicated in the table.

1/ Sec. 22 (b) (5).

	Number of beneficiaries (millions)	Reserves: Amount (billions)	Reserves: Annual interest (millions)
Social security			
1947	1.7 a/	$8.7 b/	$ 163 c/
1960	5 to 6 d/	33 to 52 e/	$ 650 to 1,010 e/
Railroad retirement			
1947	.2 a/	.8 b/	24 c/
1960	not available	2 to 3 f/	52 to 97 f/
Total			
1947	1.9	9.6	187
1960	not available	35 to 55	702 to 1,107

Note: On account of rounding, figures will not necessarily add to totals.

Sources:

a/ As of February. See Table 8, Appendix A for source.

b/ As of May. See Daily Statement of the United States Treasury for June 16, 1947, pp. 13-14.

c/ Estimated for fiscal 1947. See Budget of the United States Government for the Fiscal Year Ending June 30, 1948, Table 4, p. A7.

d/ Issues in Social Security, Report to the Committee on Ways and Means, House of Representatives, 79th Cong., 1st Sess., by the Committee's Social Security Technical Staff, 1946, Table I, p. 160. Figures as of end of year.

e/ Ibid., Table IV, p. 162, and Table F, p. 175.

f/ Railroad Retirement - Hearings Before the Committee on Interstate and Foreign Commerce, House of Representatives, 79th Cong., 1st Sess., on H. R. 1362, Part 1, pp. 58-62. The data are contained in Tables 7-10 of testimony of Mr. Latimer, Chairman of the Railroad Retirement Board.

III. Problems and issues under present law

A. The 3-percent annuity rule

1. Summary of provisions

A major feature of the treatment of annuities under the individual income tax is the so-called 3-percent rule, adopted in 1934. Prior to 1934, annuities were in general excludible in their entirety until capital was recovered. 1/ The present rule was designed to tax currently some portion of each annual annuity payment in order to avoid undue postponement of tax, while excluding the balance in order to provide for the tax-free return of principal. 2/ Under the rule, each annual amount paid is included in taxable income to the extent of 3 percent of the consideration paid for the annuity. 3/ The balance of each annual payment is excluded until the total amount excluded over a period of time is equal to the consideration. 4/ Thereafter, the entire annual annuity payment is

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1/ Under the 1926 and subsequent revenue acts, annuity payments were specifically excluded in their entirety from gross income until consideration was recovered (Sec. 213(b) (2) under Revenue Act of 1926; Sec. 22(b) (2) under Revenue Acts of 1928 and 1932). Prior to 1926, various revenue acts contained a general provision under which the amount received "as a return of premium or premiums paid" under an annuity contract was excluded from gross income (Sec. 213(b) (2) under Revenue Acts of 1918, 1921, and 1924). In general, this provision was applied so as to exempt annuities until the total amount received equalled premiums paid, after which the annuity was fully taxable. In some cases before 1926, however, annuity payments were treated as consisting partly of interest and partly of return of principal, as determined on the basis of actuarial computations. See Revenue Revision of 1934, Hearings before the Committee on Ways and Means, 73rd Cong., 2nd Sess., pp. 142-143; also S.M. 3434, C.B. IV-1, 1925, p. 29, cited in The Taxation of Pensions and Annuities, a report on H.R. 2948, 79th Cong., 2nd Sess., p. 32.

2/ See Prevention of Tax Avoidance, Preliminary Report of a Subcommittee of the Committee on Ways and Means, 1933, reprinted in Revenue Revision of 1934, Hearings before the Committee on Ways and Means, 73rd Cong., 2nd Sess., p. 133.

3/ Where an annuity is payable during only part of a year, the amount included is 3 percent of the consideration multiplied by the number of months it was paid divided by 12.

4/ Amounts excluded prior to 1934 are deemed exclusions from gross income for purposes of the 3-percent annuity rule. In the case of annuities received by State and municipal employees prior to the 1939 Public Salary Act, amounts which would be counted as exclusions under the annuity provisions are treated as such, even though otherwise exempt under the then prevailing treatment of State and local government employees' compensation.

includible in taxable income. However, no tax adjustment is allowed in those cases where the annuitant dies before he has recovered his entire capital consideration tax-free. 1/ If the annual annuity payment is not more than 3 percent of the consideration, the entire amount is included in taxable income and nothing is excluded. 2/

Contributory employee annuities (that is, pensions financed partially by contributions from the employee's wages) are treated as annuities subject to the 3-percent annuity rule, 3/ the consideration being the employee's contributions plus any amounts contributed by the employer which were previously includible in the employee's taxable income. 4/

2. Problems

a. Inadequate allowance for return of principal

The 3-percent annuity rule tends to overstate the income element in certain annuities, resulting in the taxation of capital. The purchaser of an immediate 5/ annuity for life at standard commercial premium rates without employer contributions, for example, cannot recover his capital outlay free of tax unless he lives substantially beyond his life expectancy at the time of purchase. Moreover, in extreme instances, the annual annuity payments may be less than 3 percent of the consideration, permitting no exclusion whatsoever for the tax-free return of capital. This inadequacy of the 3-percent rule results from two factors. In the first place, the principal under an annuity investment is steadily depleted during the period of payments. Consequently, the average rate earned annually as a percent of the original investment, is about one-half the net earnings rate on annuity reserve investments. Secondly, the 1945 net rate of interest earnings of life insurance companies in the United States on their invested funds was 3.07 percent, or one-fourth less than the

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1/ I.T. 2915, C.B. XIV-2 (1935), pp. 98-99. I.T. 3364, C.B. 1940-1, p. 19.

2/ It may be noted that almost half of the States levying income taxes have adopted the Federal 3-percent rule. The rest generally apply the pre-1934 rule. For a detailed discussion of State annuity provisions, see The Taxation of Pensions and Annuities, op. cit., Appendix A, pp. 25-31.

3/ A partial exception should be noted in the case of distributions from an employee's trust prior to 1942. Such amounts are taxable only to the extent they exceed the amount paid in by the employee. Sec. 165, I.R.C., before amendment by the Revenue Act of 1942.

4/ Secs. 22(b) (2) (B) and 165 (c).

5/ An immediate, as distinguished from a deferred annuity is one where payments begin immediately after purchase of the contract.

average earnings rate for the decade 1930-39 of 4.10 percent. 1/ In contrast with the 1945 earnings of 3 percent and the indicated downward trend, the net rate of earnings on annuity reserve investments would need to be 6 percent for the average purchaser of an immediate annuity to obtain the contemplated tax-free return of cpaital. At the time of enactment of the 3-percent rule in 1934, it was recognized that the 3 percent would merely approximate the interest-earnings element. However, it was felt that the 3-percent figure was consistent with the objective of including some reasonable portion of each annuity payment in gross income in order to prevent undue postponement of tax. 2/

Illustration 1. Immediate annuity. A man, aged 65, buys an immediate annuity for life. On the basis of current insurance company premium rates, the premium is $10,000 for an annuity of about $750 a year, payable on a monthly basis, without refund at death. The 3-percent rule requires such annuitant to include $300 in his taxable annual income and to exclude $450 each year for the first 22 years. However, his life expectancy, according to the 1937 Standard Annuity Table, is 14.4 years. Thus, he would not obtain tax-free recovery of his consideration until the 23rd year, or approximately 8 years beyond his life expectancy. 3/ The resulting overestimate of taxable income from immediate annuities and taxation of return of capital discriminates against such annuities and constitutes a substantial tax barrier to this form of investment.

1/ Life Insurance 1946 Fact Book, Institute of Life Insurance, New York, p. 41.

2/ The problem of obtaining tax-free return of capital was anticipated in 1934 by both Treasury and insurance company representatives. See Revenue Revision of 1934, Hearings before the Ways and Means Committee, 73rd Cong., 2nd Sess., pp. 142-143, and 552-569; also Hearings before the Senate Committee on Finance, Revenue Act of 1934, pp. 119-120.

3/ Assuming that he also has $550 of other income (the minimum amount subject to tax for a single person with no dependents under present law Supplement T tax table), he would pay tax on $4,500 of income over a period of 15 years, or substantially more than he would pay if he invested $10,000 in bonds at 3 percent and cashed or marketed enough bonds each year to furnish $750 annually from principal and interest. Although the purchase of bonds would avoid the indicated tax disadvantage of an immediate annuity, it would lack the insurance protection of the annuity in the event the individual lives beyond his life expectancy. In this context, the 3-percent rule may be said to tax the purchaser of an immediate annuity for the privilege of assuring himself a minimum income in the event he lives beyond his life expectancy.

Overstatement of income under the 3-percent rule is usually avoided in the case of deferred or employer-financed annuities. In these cases accrued interest and employer contributions ordinarily account for such a large portion of the annuity payments that the 3-percent rule does not overestimate the income portion of the annuitant's receipts.

Illustration 2. Deferred annuity. A man at the age of 40 purchases a deferred annuity of $750 yearly, payable on a monthly basis, to begin when he is 65. Provision is made for refund at death before but not after 65. The consideration, computed as a single premium approximating the rate which would now be charged by an insurance company, is about $6,000. His life expectancy at 65 is 14.4 years. When payments begin under the 3-percent rule, he includes $180 in his gross income for the first 10 years, excluding $570 each year. Such annuitants can recover their entire consideration in the 11th year (about 3 years before attainment of the life expectancy at 65), after which the payments are fully includible in taxable income.

Illustration 3. Contributory employee annuity. A retired school teacher under a retirement plan partially financed by employer contributions retires with a life pension of $900 a year, toward which she has contributed about $1,800. Life expectancy at time of retirement is 24 years. Under the 3-percent rule, $54 is included in gross income and $846 is excluded for the first 2 years. In the 3rd year $792 is included on which she would pay $40 of tax under the tax table, if she has no dependents. Only $108 is excluded since this makes the total amount excluded equal to the annuitant's consideration. Thus, in the 4th year her entire annuity income of $900 becomes taxable and she is liable for $61 of tax. As indicated by the illustration, the annuitant under a contributory employee annuity recovers his consideration tax-free well within his life expectancy.

b. Income distortion under the 3-percent rule

Even where the 3-percent formula provides adequate allowance for tax-free return of principal, it introduces an artificial fluctuation in taxable income which may seriously distort the measurement of the annuitant's income and taxpaying ability. This income distortion is characteristic not only of present law and the pre-1934 annuity provisions, 1/ but also of any (percentage-inclusion) rule which prescribes the inclusion in income of a fixed percentage of the cost of the annuity. This problem is particularly serious in the case of low-income annuitants. Thus, where the includible portion of the annuity, computed as 3 percent of consideration, together with any other income, is less than the annuitant's personal exemption and deductions, some or all of the amount excluded as tax-free return of capital would be nontaxable in any event. In these cases, the exclusion for return of capital overlaps the amounts allowed for personal exemption and deductions

1/ The pre-1934 treatment produced the same type of income distortion but to an even greater extent since under it all of the annuity was first excluded.

with a resulting wastage or failure to obtain full tax benefit for one or the other of the allowances. 1/ Such annuitants would pay less tax if, instead of "bunching" their tax-free recovery of capital in a few early years, they were allowed to spread their exclusions over a longer period. If the annuitant in Illustration 3 were permitted to include $549 2/ of her pension in taxable income each year and exclude $351, this would spread the period of capital recovery into the 6th year. Thus, she would be exempt from tax, assuming she has no other income, for 5 years as compared with 2 years under present law.

c. Other problems

(1) Losses of short-lived annuitants

It is claimed that the present annuity provisions are unjust in that they require the annuitant to report a part of his receipts as taxable income without allowing for appropriate adjustments for annuitants who die before recovering the entire capital consideration tax-free. Since the entire receipts of annuitants who live long enough to recover their capital tax-free are fully includible in taxable income for annuitants as a group a larger amount of receipts is included in taxable income than the amount of income they actually realize. In this connection, it is urged that the 3-percent rule is less satisfactory than the pre-1934 rule, since the latter did not treat any portion of annuity receipts as taxable until principal was recovered.

(2) Complexities

The present 3-percent rule is not entirely satisfactory in terms of compliance and administration, since the amount of annuity receipts which must be included in taxable income changes as the capital consideration is recovered tax-free.

Illustration 4. Three different levels of taxable income under an annuity. An individual receives an annuity of $1,000 annually, the cost of which was $10,000. First, he includes $300 in taxable income and excludes $700 each year for 14 years. Then, in the 15th year, he includes $800 and excludes $200. Finally, in the 16th and all subsequent years, he includes the entire $1,000 in income.

The reporting of annuity income under present law requires computation and cumulative record-keeping by the taxpayer which might otherwise be avoided. It involves a number of entries with respect to the cost of the annuity, amounts recovered tax-free in prior years and remainder yet to be recovered tax-free, and the amount received in the current year and the portion thereof to be included in taxable income.

1/ It should be noted that the wastage of personal exemption, etc. is only an extreme form of tax discrimination against irregular income under a graduated income tax.

2/ Maximum amount of adjusted gross income not subject to tax for a single individual with no dependents under the present law Supplement T tax table.

In a field as complicated as the treatment of annuities, involving the segregation of income and capital elements, some misunderstanding and confusion on the part of some taxpayers are probably inevitable. The underlying concepts and purposes of the 3-percent rule are not complicated. However, there appears to be some taxpayer misunderstanding of the significance of the 3-percent figure and its method of application.

B. Special exemptions

Pensions, annuities, and retirement pay in general are includible in taxable income either in their entirety or to the extent provided by the 3-percent rule, where applicable. 1/ However, certain classes of pensions, annuities, or retirement benefits are exempt.

1. Exempt classes

a. Social security and railroad retirement pensions

Pensions paid to retired employees under the Railroad Retirement Act are exempt by specific provision of the Act. 2/ Social security old-age and survivors' insurance benefits have been interpreted to be similarly exempt by Treasury ruling. 3/

b. Compensation for injuries or sickness and disability retirement pay

Amounts received, through accident or health insurance 4/ or under workmen's compensation acts, as compensation for personal injuries or sickness, as well as amounts received as damages whether by suit or by agreement, and amounts received as a pension, annuity, or similar allowance for personal injury or sickness resulting from active service in the armed forces of any country, are exempt. 5/

The military retirement pay of regular Army and Navy personnel retired on account of physical disability is exempt under Section 22(b) (5). However, the ordinary retirement pay of regular Army and Navy personnel is taxable.

Under civilian retirement pension plans, pensions paid where retirement is on account of disability are generally not treated differently from ordinary retirement pensions. However, in some instances, disability

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1/ Ordinary pensions financed entirely by the employer and paid as wages in consideration of past employee services are like wages or other remuneration for personal services. As such, they are includible in gross income under the general definition of "gross income" under Sec. 22(a). However, pensions paid under employee pension or annuity plans are classified as employees' annuities taxed subject to detailed rules set forth in Secs. 22(b)(2)(B), 23(p), and 165(b) and (c). See also Appendix D.

2/ See also I.T. 3069, C.B. 1937-1, p. 59.

3/ I.T. 3447, C.B. 1941-1, p. 191.

4/ Excepting amounts attributable to, and not in excess of, medical expense deductions under Sec. 23(x) in any prior year.

5/ Under Sec. 22(b)(5).

retirement payments qualify under the terms of the retirement plan as exempt compensation. 1/

c. Pensions which are gratuities

So-called pensions, awarded by one to whom no services have been rendered, are deemed gifts or gratuities and as such are not subject to income tax. 2/ However, pensions paid to beneficiaries of a deceased employee by an employer under certain conditions do constitute taxable income to the beneficiary. 3/ Examples of pensions considered to be gratuities are benefits paid by the International Typographical Union Pension Fund, 4/ and portions of teachers' retirement and survivor pensions sponsored by the Carnegie Foundation for the Advancement of Teaching. 5/

2. Equity and revenue considerations

The exclusion of special classes of retirement payments discriminates against other annuitants, retired persons living on interest or other investment income, elderly people who are still working for wages, as well as taxpayers in general. Insofar as these exempt payments are financed by employers they are, in effect, deferred wages comparable to retirement payments derived from employer contributions under private pension plans. To the extent that the benefit payments represent employee payroll tax contributions, they are analogous to the consideration paid for retirement benefits by recipients of ordinary employee annuities. The portion of benefit payments which is attributable to Government grants may be regarded as similar to public welfare payments or gratuitous pensions.

The discrimination inherent in exempting the entire amount of retirement payments is particularly striking in the case of railroad retirement pensions and social security old-age and survivors' benefits. The exemption of $1,440 of railroad retirement pensions had little practical significance when enacted in 1935; personal exemptions were $1,000 for a single individual and $2,500 for a married couple with a 10-percent earned income credit against the normal tax and the starting rate was 4 percent. Under present law, however, the exemption is significant, since the personal exemptions are relatively low and the starting rate of 19 percent is almost 5 times higher than in 1935. Consequently, the recipient of an exempt $1,440 railroad retirement pension may be viewed as receiving a current tax advantage of $151 if single and $56 if married (with no dependents and no other income) compared with similarly situated

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1/ For example, some payments made from certain types of funds established by municipalities which are paid only as a result of disability due to injuries received in line of duty, etc. may be treated as exempt under Sec. 22(b)(5).
2/ Regulations 111, Sec. 29.22(a)-2.
3/ I.T. 3840, I.R.B. No. 4, 1947, pp. 2 and 3.
4/ See Tax Exemption of Annuity Payments under Civil Service Retirement, Hearing before the Committee on Finance, U.S. Senate, 79th Cong., 2nd Sess., on H.R. 2948, February 28, 1946, pp. 30-34.
5/ L.O. 1040, C.B. No. 3, 1920, p. 120.

annuitants who must include the entire $1,440 in taxable income. While social security payments by themselves are below personal exemption levels, except in rare cases, instances where the recipient has other income may become fairly numerous, especially where payments from private industrial pension plans are made in addition to those from social security old-age and survivors' insurance. Questions may also be raised with regard to the equity of exempting certain pensions which are classed as gifts.

Specific mention should be made of a number of points raised by the treatment of disability retirement payments in both the military and civilian fields. Inequalities appear to exist within the field of military pensions owing to the taxation of ordinary retirement pay of regular Army and Navy personnel and exemption of similar payments on account of disability. 1/ Of a total of about 68,000 regular Army and Navy personnel now in retired and inactive status, a high proportion are retired because of physical disability. 2/

In the military field, the results may often be anomalous since disability for purposes of military service may not always involve significant disability for civilian employment. 3/ Substantial tax advantages may be derived by retired Army and Navy personnel whose disabilities are relatively small by civilian employment standards. Moreover, significant inequalities may arise, for example, as between 2 retired officers with the same income and family circumstances, where both are the same age and equally disabled, but one was retired prior to retirement age due to disability and the other retired on account of superannuation and later developed the disabilities commonly associated with advanced years.

While comparable inequalities may not be encountered in the field of civilian pensions, questions are raised with regard to the rationale underlying the exemption of disability payments under Section 22(b)(5). The exemption of amounts received through accident or health insurance, or under workmen's compensation acts for personal injury or sickness, or as damages on account of such injury or sickness has been provided under every revenue act since 1918. The 1918 provision, specifically exempting such amounts, was apparently designed to remove existing doubts whether they would constitute income for tax purposes under then prevailing concepts of taxable income. 4/ The exemption of disability payments provided under Section 22(b)(5) is based on type of payment rather than on the disability of the recipient as such. Consequently, the question is raised as to the basis for the difference in treatment under the income tax which is accorded to employees whose disability retirement pay does not qualify

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1/ In this connection, it may be noted that H.R. 2163, 80th Cong., 1st Sess., would exempt the first $1,500 each year of regular retirement pay of military and naval personnel.
2/ For more detailed information regarding numbers of retired Army and Navy personnel, see Section IV, below, and Table 8, Appendix A.
3/ The Taxation of Pensions and Annuities, op. cit., p. 23.
4/ See Report of Ways and Means Committee, 65th Cong., 2nd Sess., House Report 767, pp. 9-10.

for exemption under Section 22(b)(5). 1/ Moreover, it is sometimes urged that a case for the exemption of disability payments cannot be made unless similar exemption is granted to all disabled persons regardless of source of income. 2/ In this connection, it should be noted that proposals have been made to provide a special exemption for handicapped persons similar to the $500 blind deduction provided under Section 23(y).

Problems have also arisen in the interpretation and application of this section to civilian disability payments, particularly in the case of municipal and public employees. It is often difficult to determine whether a particular payment meets the tests laid down by the statute. For example, it may be difficult to ascertain whether a particular payment is compensation for injuries or sickness in the nature of workmen's compensation or damages or whether it is a retirement pension or benefit in consideration of employment and the employee's contributions to the fund, the employee's disability being merely one of the incidents connected with his retirement or receipt of benefits. 3/ Where the exemption of disability payments hinges on distinctions of this character, some disparities and anomalies necessarily result.

The revenue losses directly resulting from the existing exemptions appear to be small at the present time in relation to total income tax yields. 4/ Assuming income payments of $166 billion in calendar 1947, it is estimated that the exclusion from gross income of social security old-age and survivors' insurance benefits results in an annual revenue loss of about $23 million. Similarly, the exclusion of railroad retirement pensions is estimated to cost about $10 million. By 1957, it is estimated that the exemption of social security old-age and survivors' insurance will cost about $75 million and the exemption of railroad retirement pensions, about $15 million, assuming the same level of income payments, present law rates of tax and personal exemptions. Thus, revenue losses due to these special exemptions will tend to increase along with the maturity of social security and railroad retirement programs.

1/ H.R. 2678, 80th Cong., 1st Sess., would eliminate this difference among employees of State and local governments by exempting disability pensions of such employees. See Hearings before the Ways and Means Committee on Miscellaneous Bills, pp. 217-219.

2/ Watson, A.D. "Income Tax on Annuity Payments," Transactions, Actuarial Society of America, 1940, Vol. XLI, Part 1, No. 103, p. 31, footnote. However, it should be noted that the author also points out that he does not believe a good case can be made for such general exemption for disability.

3/ Sickness disability benefits and disability pensions (other than for accidental injury in the course of employment) under a company-employee plan have been interpreted to constitute taxable income. However, accident disability benefits under a plan which expressly provides that the employee may elect to accept benefits under the plan or to prosecute claims are considered exempt as damages received by agreement, I.T. 3306, C.B. 1939-2, p. 149, and G.C.M. 23511, C.B. 1943, p. 86.

4/ The estimates of revenue effect cited in this report were prepared in early summer of 1947 on the basis of the unrevised national income series of the Department of Commerce. For the statistical and conceptual differences between this series and the new series on "personal income," see National Income Supplement to the Survey of Current Business, July 1947

If provision were made for the extension of a $1,440 annual exclusion applicable to all kinds of pension and annuity income, it is estimated that present law revenues would be reduced by an additional $32 million in 1947.1/ A $1,440 pension exclusion in combination with regular personal exemptions and deductions would raise the effective income exemption to very substantial levels for these individuals. For example, with the $1,440 exclusion superimposed on the present law personal exemptions and deductions, individuals with at least $1,440 of pension income would not be subject to Federal income tax on incomes up to $1,990 in the case of single persons and $2,565 in the case of married couples.

3. Proposals to create additional exempt classes

a. Pension and annuity exemptions

The existence of special exemptions for particular pension groups is a constant irritant encouraging demands for similar treatment of other pensions and annuities. In the 79th Congress, a considerable number of bills were introduced which would provide special exemptions applicable to one or more classes of pensions or annuities. An important example is H.R. 2948, 79th Congress, 2nd Session, which was to exempt the first $1,440 of Civil Service retirement annuity payments in any year. Although opposed by members of the Ways and Means Committee, H.R. 2948 was passed by the House of Representatives September 27, 1945. and referred to the Senate Finance Committee. The Treasury Department opposed the measure and also recommended that social security old-age and survivor's benefits and railroad retirement pensions be made subject to the generally applicable revenue laws. Public hearings were held on the bill February 28, 1946. 2/ At the request of the Senate Finance Committee, the Staff of the Joint Committee on Internal Revenue Taxation prepared a report on H.R. 2948. This report was unfavorable to the proposed exemption. 3/ A number of similar measures have been introduced in the

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1/ Under H.R. 1613, 80th Cong., 1st Sess., a $1,440 annual exclusion would be granted applicable to the retirement pensions of all governmental employees, including retired employees of Federal, State and local governments or their agencies. It is estimated that this legislation, if enacted, would reduce revenues about $9.5 million in 1947. Proposals for the exemption of annuity payments of retired Federal Government employees are sometimes made as an alternative to an increase in annuities to take account of higher living costs. Similar exemptions for State and local employees might also be regarded as a means of relieving the burden of an upward adjustment of retirement pay on State and local governments.

2/ See Tax Exemption of Annuity Payments under Civil Service Retirement, op. cit.

3/ The Taxation of Pensions and Annuities, op. cit., p. 1.

80th Congress. 1/

b. Special age exemption in lieu of retirement income exemption

H.R. 1 (80th Congress, 1st Session), the individual income tax reduction measure, applicable to incomes received in 1947 and 1948 and later years, 2/ provided a special $500 exemption for persons over 65 years of age. 3/ It is estimated that the age exemption would reduce the income tax liability of 2.9 million persons of whom 995,000 would be made nontaxable. The revenue reduction under H.R. 1 attributable to this feature is estimated at $227 million for calendar 1947 and at $196 million for calendar 1948, assuming $166 billion income payments.

As reported by the Ways and Means Committee and passed by the House, the age provision was coupled with a limitation requiring persons otherwise qualifying for the age exemption to include in their gross income the first $500 received each year from fully exempt pensions other than

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1/ For example, H.R. 32, 80th Cong., 1st Sess., would exempt the retirement annuities of State, county, and municipal employees up to $2,000 a year; H.R. 291 and S. 58 would entirely exempt Federal Civil Service retirement pensions; H.R. 964 would provide a special $2,000 exemption applicable to retirement pensions paid to employees of the Federal Government or any State, Territory, possession, or their political subdivisions, governmental corporations, or corporations exempt under Sec. 101(6) of the Internal Revenue Code; H.R. 2189 would exempt all governmental retirement annuities up to $2,500; H.R. 456 would exempt the first $1,440 of any retirement pension or annuity payment; H.R. 738 would exempt the first $1,440 of Civil Service retirement pensions; H.R. 855 and H.R. 1613 would apply a $1,440 exemption to the retirement annuities of all governmental employees; H.R. 963 would entirely exempt all retirement benefits paid by Federal, State or local governments.

2/ Passed by the Congress June 3, 1947, vetoed by the President June 16, 1947 and veto sustained in the House of Representatives June 17, 1947.

3/ The additional exemption was $1,000 on joint returns where both husband and wife are over 65. Similarly, the taxpayer filing a separate return was allowed an additional $500 exemption for his wife if she is over 65 and does not file a separate return. No additional exemption would be allowed for dependents over 65. This superseded the House bill provision under which the $500 age exemption was allowed only with respect to persons whose gross income was $500 or more. See Senate Finance Committee Report on H.R. 1, Senate Report No. 173, 80th Cong., 1st Sess., p. 15.

veterans' benefits or lump-sum benefits. 1/ This limitation was not included in the Senate bill or in the final measure passed by the Congress. The Senate Finance Committee stated that it was in complete accord with the objective of the limitation, but owing to the difficulty of determining the types of exempt income covered by the provision and the administrative complexities it was considered desirable to defer action on the problem. The Finance Committee report indicated that the $500 age exemption might constitute the basis for removing existing pension and annuity exemptions. 2/

Both the Ways and Means Committee and Finance Committee Reports on H.R. 1 stated that the $500 age exemption was designed to recognize the economic handicaps of elderly persons. They further stated that the age exemption was considered a more appropriate method of relief than piecemeal extension of the system of exclusions for particular types of retirement income. It was also indicated that the $500 age exemption was regarded as a method of dealing with the problem of existing discrimination between recipients of taxable and tax-exempt pension and annuity income. 3/ With regard to the latter objective, it will be noted that in the absence of the pension offset provision included in the original House bill or similar provision designed to bring exempt pension income within the tax base, the age exemption tends to superimpose an additional special tax benefit on top of that already enjoyed by recipients of tax-exempt retirement income. However, it should be recognized that the age exemption as adopted under H.R. 1 would tend to reduce the practical importance of existing inequalities and problems in the pension and annuity field, by dropping many pension and annuity recipients from the tax rolls and substantially reducing the tax liability of others.

1/ In general, the limitation was designed to reduce the age exemption by the amount of special pension exemption already enjoyed, but not to disturb the existing exemption of non-military health, sickness, and accident benefits exempt under Sec. 22(b)(5) or military and veterans' benefits exempt under provisions of law other than Sec. 22(b)(5) of the Internal Revenue Code. Among the types of exempt pension and retirement income affected by this feature of the House bill are (1) old-age and survivors' insurance benefits under the Social Security Act, except lump-sum payments, (2) railroad retirement benefits, except lump-sum payments, (3) disability pensions of the regular armed forces and of temporary officers of World War II, now exempt under Sec. 22(b)(5), (4) Navy pensions provided under Revised Statutes, Secs. 4756 and 4757, (5) certain gratuitous retirement pension benefits, such as those paid by the Carnegie Foundation to retired teachers and by the International Typographical Union Pension Fund for retired typographical workers, and (6) pensions paid by States to veterans of various wars. Certain types of exempt pension benefits not affected include (in addition to lump-sum benefits under the Social Security and Railroad Retirement Acts) (1) disability pensions of emergency officers of World War I, (2) all veterans' pensions administered by the Veterans Administration, (3) Army and Navy Medal of Honor Roll pensions, (4) sickness, health and accident benefits received under workmen's compensation laws, private health or accident insurance, or as damages awarded by lawsuit or agreement, and (5) lump-sum bonuses paid by States to veterans of World War II.

2/ Senate Finance Committee Report on H.R. 1, op. cit., p. 15.

3/ House of Representatives Report No. 180, 80th Cong., 1st Sess., p. 15, Senate Report No. 173, op. cit., pp. 14-15.

In so doing, however, it would create a new and possibly more important distinction in the tax treatment of persons over 65 as compared with other taxpayers. This feature of H.R. 1 raises issues with regard to the income tax treatment of elderly (or handicapped) persons which are outside the scope of this study.

C. Lump-sum payments

1. Distributions under retirement plans

Where the total amount payable to an employee under qualified stock-bonus, pension, or profit-sharing employees' trust plans 1/ is paid out in the form of one annual settlement on account of separation of the employee from service (including termination of employment due to the employee's death), the amount received in excess of the employee's contributions is treated as a long-term capital gain. 2/ This treatment is not available to lump-sum distributions under non-trusteed annuity plans. Consequently, such distributions due to death or severance from employment under non-trusteed plans are treated as ordinary income to the extent they exceed the employee's contributions. However, when such distribution is made in the form of an annuity contract to an employee, it is not considered to be taxable income, even though it has cash or surrender value, unless the employee actually cashes the contract. 3/

Long-term capital gains treatment as applied to lump-sum distributions of deferred compensation and accrued interest serves to avoid hardship in the absence of an adequate income-averaging procedure. However, capital gains treatment may be an inadequate substitute for income-averaging in some instances and in other cases may provide a loophole for converting ordinary income into capital gains for the purpose of obtaining preferential tax treatment. Moreover, capital gains treatment might in some instances encourage single-sum settlements in lieu of retirement pensions, thus tending to defeat the purpose of retirement plans.

2. Purchase of annuity contract outside qualified plan

By contrast with the favorable capital gains treatment accorded certain lump-sum distributions noted above, the vesting of an annuity contract in an employee, for example through the purchase of a single-premium annuity contract outside a qualified plan, results in the employee paying tax on the entire value of the contract as income constructively received in one year. Employers sometimes find it desirable to meet their responsibility towards a retired employee by purchasing an annuity contract and designating him as the beneficiary.

1/ Qualified for exemption under Sec. 165(a).
2/ Under Sec. 165(b).
3/ Regulations 111, Sec. 29.165-6.

Proposals have been made to mitigate the impact of the tax on the employee where the value of such contracts is taxed as ordinary income by currently excluding the value of the contract from the employee's income and including the entire annuity in gross income when received. However, to allow an employer, outside of a qualified retirement program, to deduct the entire cost of an annuity contract in one year and then to allow the employee to include his pension in income as received would virtually remove the sanctions against unqualified plans. 1/ It would open broad avenues for avoidance through both the timing of such transactions to coincide with high business income and tax rates and the conversion, on a large scale, of ordinary salary compensation into retirement benefits subject to lower individual income tax.

3. Exemption of survivor benefits qualifying as life insurance proceeds

Some retirement plans provide benefits under life insurance contracts to survivors of employees who die prior to retirement. 2/ Such payments are exempt as life insurance proceeds payable by reason of the death of the insured. This tends to discriminate against beneficiaries under other types of plans who receive refunds payable on death of the employee prior to retirement which, although similar in substance, do not qualify as life insurance proceeds and are thus taxable. 3/

D. Comparative treatment of employer and employee contributions under retirement plans

While employee contributions to retirement funds are not currently deductible or excludible from wages, employer contributions under qualified plans are not currently taxed to the employee. 4/ This treatment tends to confer substantial tax advantages on the provision of retirement benefits through employer contributions as compared with employee contributions. In addition to the advantage of tax deferment, such benefits would generally be subject either to lower rates of tax or exempt, since they would be included in the employee's income after retirement, which ordinarily is substantially lower than during his employment. The tax advantage would vary in value depending on whether the trend of tax burdens is downward or upward. Moreover, comparatively high employer contributions also tend to be preferable because under the 3-percent rule there would be less chance of wastage of tax-free recovery of capital. Consequently, there would seem to be a better chance of paying a smaller aggregate income tax during the working and retirement periods of the employee if he is under a pension plan which includes a relatively high proportion of employer contributions. That is, the employee whose

1/ See Secs. 165 and 23(p).
2/ However, the premium value of the term insurance portion of the contract attributable to the employer contribution is currently includible in the employee's taxable income as wages. See Regulations 111, Sec. 29.165-6.
3/ Either as ordinary income or as long-term capital gains, as previously noted.
4/ Under non-qualified plans, retirement benefits contributed by the employer which give the employee a nonforfeitable beneficial interest are currently included in the employee's wages.

employer pays a lower nominal wage and supplements it with retirement benefits appears to have a tax advantage over another employee in the same substantive position who receives a higher money wage subject to larger deductions for retirement.

It appears that the existing provisions have tended to encourage noncontributory as against contributory plans and, under contributory plans, a higher ratio of employer to employee contributions. It is estimated that roughly two-thirds of the qualified industrial retirement pension plans are noncontributory, that is, financed solely by the employer, and that one-third of the plans are contributory, involving joint sharing of cost by employer and employee.

During the war there was a noticeable shift towards noncontributory plans owing to the stimulus of wage and salary stabilization and high wartime tax rates. Since the war there has been a reverse tendency.

E. Exemption of installment payment of life insurance proceeds by reason of death of the insured

Under present law and regulations, life insurance proceeds payable by reason of death of the insured are entirely exempt whether paid in a lump sum or in installments, including the element of interest earned after the death of the insured.

Section 22(b)(1) excludes from gross income "amounts received under a life insurance contract paid by reason of the death of the insured, whether in a single sum or otherwise (but if such amounts are held by the insurer under an agreement to pay interest thereon, the interest payments shall be included in gross income)." Former regulations sought to implement this provision by treating installment payments chosen as an option in lieu of a specified lump sum as consisting partly of capital and partly of interest accruing after death of the insured. 1/ However, in view of court decisions which failed to sustain these regulations, 2/ they were amended to exempt such life insurance proceeds in their entirety, including the interest element earned after the death of the insured, where they represent amounts stated on the face of the policy. 3/

The exemption of such installment payments in their entirety makes possible the exclusion from taxable income of a larger aggregate amount than the lump sum payable at the time of death of the insured. This exemption of the interest income encourages the choice of installment

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1/ These provisions did not apply the 3-percent rule to such payments but provided for the exclusion of a portion of each payment equal to the lump sum payable at the time of the death of the insured, divided by the number of years the payments were expected to run. Prior regulations taxing such amounts, whether either the insured or the beneficiary exercised the installment option, were later modified to apply only when the beneficiary exercised the option.

2/ Pierce, Katharine C. 2 T.C. 832, and 146 Fed. (2d) 388.

3/ T.D. 5515, approved May 16, 1946, C.B. 1946-1, p. 26.

payments of insurance proceeds and discriminates against the widow or other heir whose share in an estate is invested directly in Government bonds or a farm or business as compared with one whose capital is held for investment in the form of life insurance reserves.

F. Tax avoidance under deferred annuity contracts

Interest earned on funds invested in deferred annuities is not included currently in taxable income. However, it is included in income as it is received in the form of a cash annuity payment and segregated from the return of consideration under the 3-percent annuity rule. In addition to the usual advantage of postponing tax, this treatment may defer the receipt of income from annuity investments to a period when, generally speaking, the individual's income is lower and, therefore, subject to lower rates of tax.

The privilege of tax postponement on interest earned under deferred annuity contracts is not unique. It is also enjoyed by investors in life insurance and, as already noted, where proceeds are paid by reason of death of the insured, complete exemption is granted. Similarly, individuals owning assets which include unrealized capital gains may either postpone income tax liability on such gains or avoid income tax entirely by transferring such assets by gift or at death. Taxpayers on a cash basis may defer inclusion of interest on accrual bonds, such as Series E and F United States savings bonds until redemption or maturity.

To some extent the current exclusion of interest on deferred annuity contracts may be justified as an encouragement to systematic and institutionally protected savings for old age. Moreover, many annuity contracts are tied to life insurance policies where the exemption or postponement of the inclusion of interest on reserves is a traditional feature of the income tax. It would be difficult from the standpoint of compliance and administration to require the computation and current reporting of small amounts of such interest.

While the deferred recognition for tax purposes of investment income arising under both annuity and insurance arrangements raises basic questions of income tax policy, the major problem of tax avoidance referred to here is the possible purchase by investors on a substantial scale of deferred annuity contracts with a view to avoiding tax. To some extent there is an automatic check on annuity investments for tax avoidance since the hazard of loss of income or capital in the event of premature death which is characteristic of annuity investment and the low rate of return after loading charges would discourage many individuals from investing substantial amounts in this form. Nevertheless, the temporary postponement of tax and possible ultimate exemption from tax of such interest involve discrimination against taxpayers whose savings are invested through channels where interest is currently taxed. It also results in lower revenues.

G. Areas of uncertainty in the treatment of annuities

1. Definition of annuities and treatment of refund annuities

Some doubt apparently exists as to the definition of an annuity for the purpose of applying the 3-percent rule. Under existing regulations, the 3-percent rule is applicable to payments under an annuity or endowment contract whether for a fixed period, such as a term of years, or for an indefinite period, as for life. 1/ However, it has been held that (a) an annuity contemplates using up of principal in making periodic payments, the annuitant having a right only to the payments and not the principal fund from which they are derived, and (b) a true annuity is for an indefinite period, such as for life or for a guaranteed fixed period and remaining life thereafter. Thus, installment payments under an endowment contract, equivalent to an annuity certain not involving a life contingency, have been entirely exempted until cost was recovered. 2/

There also appears to be uncertainty about the application of the general rule that payments to a survivor annuitant are includible in taxable income to the same extent as though the original annuitant had lived and received such payments. 3/ Under true joint and survivor annuity contracts, the 3-percent rule applies to the survivor as well as to the original annuitant, the consideration being the same for purposes of either recipient. 4/ However, under some refund annuity contracts the application of the 3-percent rule is interrupted by the death of the original annuitant. 5/

1/ Regulations 111, Sec. 29.22(b)(2)-2.

2/ Thornley, George H. 2 T.C. 220, non-acquiesced. Commissioner's appeal dismissed (nolle prosse) March 8, 1944.

3/ In the case of employees' annuities the law and regulations provide specifically that the annuity paid to the employee's widow or other beneficiary under the contract shall be included in the beneficiary's gross income to the same extent it would be included in the employee's gross income if employee had lived and received the payments. See Sec. 165(b) and Regulations 111, Secs. 29.22(b)(2)-5, 29.165-6, and Sec. 126(a).

4/ See, for example, MacArthur v. Commissioner, 8 T.C. No. 32, February 10, 1947.

5/ Where the refund annuitant acquires by gift from the purchaser of a single-premium refund annuity contract an indefeasible right to the annuity payments and the refund payments at the time of the purchase of the contract by reason of the purchaser having relinquished all rights to change the beneficiary and demand the cash surrender value of the contract, the refund payments are exempt until the payments made in the future, when added to the payments previously received tax-free, equal the consideration paid for the contract. Where the rights under such a contract are acquired by the refund annuitant only upon the death of another, the contract being revocable by the purchaser prior to such death, the basis is the commuted value of the future refund payments as of the date of death and the payments are divided each year into taxable and nontaxable portions. See I.T. 3322, C.B. 1939-2, p. 177, superseding and modifying I.T. 3140, C.B. 1937-2, p. 62.

2. Annuities arising out of property transactions

Certain questions have arisen with regard to the income tax treatment of transactions involving the exchange of property for an agreement to pay a number of cash installments in the nature of an annuity, where the party paying the annuity is not an insurance company. For example, a father sells property to his son receiving in exchange an annuity of $15,000 a year for life. If valued on the basis of standard life-expectancy tables, the annuity would be worth $150,000. If this were equal to the fair market value of the property, no gift tax would be paid. However, the transaction might actually have been a transfer for inadequate consideration, if the father's health were known to have been poor and he died shortly thereafter, leaving the son in possession of the property.

The questions which do not appear to be definitely settled are: 1/ (a) Is the acquisition of such an annuity a closed transaction so that gain or loss may be recognized at once? (b) Are the installment payments to be treated as an annuity, the consideration for which is the cost or value of the property exchanged depending on whether gain or loss was recognized? (c) Should the annuity be valued on the basis of a standard mortality table and standard insurance company premiums or should the particular facts of the case be taken into consideration? (d) In the case of intra-family transactions, what is the method of measuring and treating excessive consideration under the Federal estate and gift tax?

IV. Alternative solutions

There are presented below some of the possible alternative solutions to the problems and issues raised by the present income tax treatment of pensions and annuities discussed in the preceding section.

A. Change in the 3-percent annuity rule

Correction of the inadequacies of the existing 3-percent rule may be approached in three alternative ways: (1) separation of the income and capital elements to include the average income portion of annuity payments, (2) modification of the 3-percent rule to reduce or eliminate the percentage of the consideration paid required to be included in taxable income, and (3) inclusion in taxable income of an amount equal to the interest earned on the reserve remaining in the annuity.

1/ For tentative but conflicting answers, see Steenburg, BTA memo, December 1941, P.H. par. 64,392, and Randolph Paul, Studies on Federal Taxation, Third Series, pp. 393-399.

1. Inclusion of the average income portion of each annuity payment

One alternative to the 3-percent rule is to include in taxable income a portion of each annuity payment equal to the average annual income element under such a contract as determined on an average life-expectancy basis. In general, there would be included in taxable income a percentage of each annuity payment equal to the ratio which the excess of total expected receipts over the amount paid for the annuity bears to total expected receipts.

In the simplest situation, such as a lifetime annuity without refund or an annuity certain, 1/ this method would amount to excluding from gross income a portion of each annuity payment equal to the paid in consideration divided by the number of years payments were expected to continue. In the case of a lifetime annuity, the expected period of payments would be the annuitant's life expectancy when the annuity payments became effective. Appropriate life-expectancy tables could be specified by either legislation or regulation. The selection of the appropriate life-expectancy table or tables would be important from both the equity and revenue standpoints. A table indicating a lower expectation of life would result in a larger exclusion, favoring a taxpayer, while one indicating a higher expectancy would result in a smaller exclusion, favoring the Government. Use of the tables relied on by the payer in pricing the annuity might be undesirable since it would result in lack of uniformity and could open the door to tax avoidance. However, it might be desirable to apply different expectancy tables to different annuitant groups, in accordance with obvious group differences. For example, annuitants who voluntarily purchase annuity contracts from life insurance companies are a more selected group than pensioners under regular retirement plans who would tend to have more nearly the same life expectancies as members of the population at large. This method would involve little or no compliance problems for the annuitant, if the necessary information regarding the taxable portion of the annuity payment could be furnished by the company or organization paying the annuity. Thus, beginning with the first payment, the payer would state to the annuitant the portion of the annuity payments to be included in taxable income and the portion to be excluded as tax-free recovery of consideration paid. This method of taxing annuities is the one recommended by the Canadian Royal Commission on the Taxation of Annuities and Family Corporations and enacted under 1945 Canadian revenue legislation. 2/ It is also the method followed in principle under former Federal regulations applicable to annuities under life insurance policies paid by

1/ See Appendix D for a description of forms of annuities.
2/ See Appendix B, and Watson, Income Tax on Annuity Payments, op. cit.

reason of the death of the insured. It was used in taxing certain annuities under the Revenue Act of 1924 and was regarded favorably by Treasury representatives when the 3-percent rule was being considered in 1934.

The operation of the method described above is briefly illustrated below.

Illustration 1. Determination of income portion of annuity payment under average life-expectancy method. In the simplest type of case, a man aged 65 purchases an annuity of $1,200 a year for life without refund at death, payable $100 monthly, for which he pays $15,900. Total expected receipts under such a contract would be $17,280, as computed on the basis of the 1937 Standard Annuity Table. 1/ Under the formula each annuity payment would be includible in gross income to the extent of 8 percent of $1,200 or $96 a year. 2/

This method appears to offer a fair and rational way of segregating the income and capital elements of an annuity for income tax purposes. In effect, it applies for income tax purposes the principle of averaging life expectancies which underlies the determination of benefits in annuity contracts. Thus, in the average case, where the annuitant lives his life expectancy, it would include in his taxable income the exact amount of his aggregate interest on the annuity investment and exclude the exact amount of his original investment. Under this group or average procedure, annuitants who do not live their life expectancies would not be allowed an adjustment for mortality losses. These annuitants would not recover the entire amount of their capital outlay tax-free. On the other hand, annuitants who outlive their life expectancies would not be fully taxed on their gains, since the amount includible in taxable income would remain the same each year, even after they had fully recovered their capital outlay tax-free. This approach to the difficult question of how to treat for income tax purposes gains derived by long-lived and losses incurred by short-lived annuitants may be regarded as according equitable tax treatment to annuitants as a group.

1/ Under the formula $\frac{\text{Total expected receipts minus consideration}}{\text{Total expected receipts}}$ or

$\frac{\$17,280 - \$15,900}{\$17,280}$ = 8 percent. The figure $17,280 is equal to $1,200, the annual amount of the annuity, times 14.4, the annuitant's life expectancy at the age of 65.

2/ Identical results are obtained if the excludible portion of each annual payment is computed as the consideration divided by life expectancy. On this basis, the portion excluded each year would be $15,900 ÷ 14.4 or $1,104, and the amount included would thus be determined to be $1,200 - $1,104 or $96.

This method would make a portion of each payment includible in taxable income from the start, thereby avoiding undue tax postponement which led to the enactment of the 3-percent rule. 1/ It would also avoid an artificial fluctuation in taxable income such as arises under the 3-percent rule. Therefore, it would meet the problem of low-income annuitants wasting various portions of their tax-free recovery of consideration under present law. It would avoid the overtaxation of immediate annuities, characteristic of the 3-percent rule. It would more closely approximate than present law the net income realized by annuitants as a group. However, in the case of deferred annuities, it would tend to slow up the rate of tax-free recovery of capital as compared with present law, resulting in the inclusion of a larger amount of annuity receipts as taxable income for some short-lived annuitants. Long-lived annuitants, however, would gain in comparison with present law, since they would recover tax-free more than 100 percent of their capital outlay.

a. Joint and survivor annuities

Under the average life-expectancy method, there also arises the question of the proper tax treatment of joint and survivorship annuities of various types.

(1) Joint-survivor life-expectancy method

One way to treat joint and survivor annuities for income tax purposes would be to apply the average life-expectancy method to the several lives involved. This approach would treat a multiple life annuity as an integrated whole for the entire period that payments are to be made. Under this method, the same proportionate amount of each annual payment would be included in taxable income whether received by the first life or by the survivor. The annual exclusion for return of consideration would be determined from the beginning on the basis of the number of years payments were expected to continue over the combined joint and survivor expectation of life.

Illustration 1-a

To illustrate, a mother and daughter, aged 58 and 32, respectively, purchase an immediate joint and survivor annuity of $85 a month or

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1/ It is recognized that the life-expectancy method averages the income element under annuity contracts evenly over time. Thus, the timing of taxable income under this method tends to favor individual annuitants as compared with a method like the reserve-earnings approach, described below, which would impute a larger portion of the income to earlier years. See, however, Watson, Income Tax on Annuity Payments, op. cit., p. 29.

$1,020 a year, the consideration being a single premium of $32,000. Their joint and survivorship life expectancy under the 1937 Standard Annuity Table is about 45.9 years. The annual exclusion would be $697 ($32,000÷45.9) and the amount included in gross income each year payments were made to either annuitant would be $323 ($1,020 - $697).

This method is consistent with the present law approach of treating a joint-survivor annuity as income in the hands of the survivor to the same extent as if it had been received by the original annuitant. On a group basis, it would correctly measure the income elements (interest and previously untaxed compensation) received under joint-survivor annuity contracts. 1/ It would result in a constant taxable amount assuming a constant rate of annuity payments. Where the payments to the survivor are different from the amounts received by the first annuitant, the includible portion would vary in proportion to the rate of payment. 2/

Since this approach is in effect the average life-expectancy method applied to the several lives, it has the characteristic advantages and disadvantages discussed above with respect to the method as applied to one life.

(2) Commuted-value basis to the survivor 3/

Another way of applying the life-expectancy method to joint-survivor annuities is to treat payments to the first life as a single-life annuity with cost as the consideration. Payments to the survivor would then be treated as a new single-life annuity on the assumption that the consideration paid for it was equal to its market value or single premium value (commuted value) to the survivor on the date of death of the first annuitant.

Illustration 1-b

Assume as in Illustration 1-a, a joint survivor annuity of $1,020 costing $32,000 and payable annually to a woman aged 58 or to her daughter aged 32 as survivor. Of the total consideration, about $19,000 may be attributed to the life annuity for the mother, leaving about $13,000 to be attributed to the cost of the survivorship benefit.

1/ However, the imposition of an estate tax upon the commuted value of an annuity payable to a beneficiary of the decedent raises a question as to the need for an adjustment of the income tax basis of the beneficiary, since such basis may not be the same as the commuted value.

2/ As noted with respect to one-life annuities, this method may be regarded as giving the taxpayer an advantage in the nature of tax postponement as compared with a method which would treat earnings on annuity reserves as realized when accrued.

3/ The commuted value is the market value or single-premium value of the survivorship annuity as of the date of death of the first annuitant.

Treating payments to the mother as a single-life annuity costing $19,000, the excludible portion of each payment would be $844 based on a life expectancy of about 22.5 years ($19,000÷22.5). The includible portion would be $176 ($1,020-$844). Assuming the first annuitant lives out her life expectancy, and that the daughter as survivor begins to receive payments at the age of 55, the commuted value of the survivor's annuity would be about $21,000. The excludible portion of each payment to the survivor would then be about $847 ($21,000÷24.8). The includible portion would be $173 ($1,020-$847). If the first annuitant lived only 5 years after purchasing the annuity, the commuted value of the survivor annuity would be about $29,500. Under these circumstances, the excludible portion of each survivor annuity payment would be $736 ($29,500÷40.1) and the includible portion would be $284 ($1,020-$736). Thus, the portion which would be includible as taxable income to the survivor would, under this method, vary depending on the date of death of the first annuitant.

This method would in effect exempt from income tax accrued interest or untaxed wages which, upon death of the first annuitant, would be converted into a capital value as part of the cost basis of the survivor annuitant. This procedure would appear to be consistent with the exemption of life insurance proceeds payable by reason of death of the insured and with the exemption of unrealized capital gains at death. However, it would understate the income element of the annuity payments received by this group of annuitants.

It would be possible to modify this method to account for the entire income received by this group of annuitants. However, this modification would require that there be included in the expected income taxable to the first life all of the employer contributions previously not included in the employee's taxable income and the interest accruals during the period of deferment of the survivor annuity. It should be noted that this modification would make a significant departure from present income tax procedure in that it would treat as income constructively received by the first annuitants income which would actually be received only by the survivor annuitant.

(3) Split-cost method

A third approach would also treat the first-life and second-life annuities as separate entities. Unlike the commuted-value method, it would treat the survivorship annuity as merely a deferred annuity. The cost basis for the first life would be the portion of the total consideration paid for the joint and survivorship annuity, which could be attributed to a single-life annuity, the remainder of the total cost would be treated as the cost basis for the survivor benefit feature.

Illustration 1-c

Under the split-cost method, the payments under joint-survivor annuity contract cited in Illustrations 1-a and 1-b would be taxable as follows: Each annual payment to the older woman as first annuitant would be includible in gross income to the extent of \$176, just as under the method shown in Illustration 1-b. Assuming her death at the end of her life expectancy of 22.5 years, payments to the survivor, then aged 55, would be excluded to the extent of \$524 (\$13,000÷24.8). Thus, the includible portion to the survivor would be \$496 (\$1,020-\$524). However, if the original annuitant died after only 5 years, the excludible portion of each survivor payment would be \$324 (\$13,000÷40.1) and the amount included in gross income would be \$696 (\$1,020-\$324). Like the commuted-value method, the portion which would be includible in the taxable income of the survivor annuitant under this method would also vary, depending on the date of death of the first annuitant.

In general, this method would require the survivor to include a larger portion of his annual payments into his taxable income than would be required of the first annuitant. Unlike the commuted-value method, the split-cost method would not capitalize the accrued interest and untaxed wages upon death of the first annuitant, since it would use the purchaser's original cost for the survivor benefit feature as the consideration to be recovered tax-free. Although this method would also account on a group basis for the proper amount of income to be included for tax purposes, it would allocate the taxable income in a manner unfavorable to annuitants with contracts resulting in mortality losses, since they would be required to include a greater proportion of the receipts as taxable income than would annuitants under similar contracts producing mortality gains.

Summarizing the comparative aspects of the three alternatives, Method (1) treats the two lives under a joint and survivor annuity as a single unit; Methods (2) and (3) as separate units. Treating the two lives as a single unit would seem to be consistent with the fact that a close family relationship usually exists between such annuitants and would permit balancing of mortality gains against losses within the family unit. In fact, the purchasers of a joint and survivor contract probably regard it as a single package. Also, under joint and survivor annuity contracts, the contingencies of long life and premature death are so hedged against each other that it seems appropriate not to separate them. By spreading the income element evenly over two lives and avoiding abrupt changes in the taxable portion of payments at the death of one of the annuitants, it recognizes the need of participants in joint and survivor annuity contracts for regularity and certainty in their disposable income after tax.

b. Refund annuities

The life-expectancy method discussed above raises the question of how to treat refunds under annuity contracts containing refund provisions. Refund provisions under annuity contracts are designed to assure full return of capital either to the annuitant during his lifetime, or in part to the annuitant during life and the balance to his beneficiary after his death. Annuities containing refund provisions cost more than identical annuities not containing such provisions.

Refund annuities are of various types. Under one type of refund contract, the survivor beneficiary receives a lump sum equal to the cost of the contract less amounts already paid to the annuitant during his lifetime. Another type of refund provision is embodied under a contract which pays an annuity for a specific period of years and for life thereafter. The same result is obtained under a life annuity with a guaranty of payments for a specified term. Generally speaking, refund payments contain no element of income; they consist of repayment of the unrecovered investment in the annuity. One important exception, however, occurs under a deferred or employee annuity, where the refund or guaranteed payment is based on the single-premium value of the contract on the date payments begin, as distinguished from the actual consideration or premiums paid by the annuitant for the contract, which is a lower figure. In this situation, refund payments based on the higher figure may include elements of deferred wages or interest accrued during the deferred period.

One approach to the treatment of refund payments would be to exempt such payments to the extent they consist of refunds of unrecovered cost. This could be done by allowing the refund beneficiary a basis equal to the original cost less amounts already received by the annuitant. In the event of installment refund payments, the basis would be prorated over the period installments were to be paid.

In some respects the exemption of refund payments might be considered to call for a modification of the treatment of the original annuitant under refund contracts. The life expectancy method exempts part of the gains of long-lived annuitants to counterbalance the non-recognition of losses incurred by annuitants who fail to live out their life expectancy. However, under refund contracts, annuitants are protected against loss of capital. Hence, the exemption of gains where no losses can occur would weight the scales against the Government's revenues. One solution would be to reduce the cost basis of refund annuities for purposes of the capital recovery exclusion by the additional premium attributable to the refund clause in the contract. In effect, this procedure would treat the annuity cost as consisting in part of a life insurance premium and in part of the cost of a life annuity. This disallowance of the cost of the refund feature for capital recovery purposes would parallel the exemption of the refund payable in the event of death of the annuitant. The adjustment of the cost which is recognized in allowing capital recovery under refund contracts might also be applicable with respect to deferred annuity contracts with provision for refund during the deferred period (before commencement of annuity payments).

However, special treatment of refund payments might be considered unnecessary or undesirable because of the cumbersomeness of the adjustment described above or because of possible inconsistency with the treatment of survivors' benefits under joint and survivor annuities. For these or other reasons, it might be desirable to treat refund payments in a manner parallel with the provisions adopted for survivor annuities. Refund payments might be included in taxable income in the same percentage as if received as annuity payments by the original annuitant. If the split-cost method were adopted for joint and survivor annuities, it could also be applied to refunds: the refund would be taxable to the extent it exceeded the portion of the cost of the whole contract attributable to the refund feature. This method would ordinarily result in treating a substantial part of refunds as taxable income. Similarly, the commuted-value-basis method, if adopted for joint and survivor annuities, might also be applied to refund payments. The latter method would exempt refund payments, except where paid in installments over a considerable period of time.

In many respects, the methods for treating refunds described here would involve the same considerations as the application of the same method to joint-survivor payments, excepting that survivor annuities may include income in view of the remaining life contingency; while refund payments are not true annuities since they may be measured with certainty when the life contingency element is terminated by the death of the annuitant. Consequently, it may be considered desirable to entirely exempt refunds to the extent that they constitute return of principal.

2. Modification of the 3-percent rule

a. More adequate provision for capital recovery

As an alternative to the life-expectancy method discussed above, it would be possible to modify the existing 3-percent rule to provide a more adequate method for the tax-free recovery of capital. Such a modification would contain the following features: (1) The amount required to be included in taxable income would be reduced from 3 percent to some lower percentage, say 1 or $1\frac{1}{2}$ percent of the consideration paid for the annuity. 1/ This feature would be designed to avoid the overstatement of income, as in the case of immediate annuities, so that the average annuitant could exclude the full amount of his capital outlay tax-free. (2) A second feature would be to give the taxpayer the option of including a larger amount. 2/ This feature would permit annuitants to vary the amount of the annual payments to be included in taxable income so that they could avoid wasting amounts of tax-free exclusions which would not yield a tax benefit. As under present law, amounts excluded from taxable income would be cumulated until the consideration was recovered tax-free, after which the entire annual payment would be included in taxable income. This method is illustrated below.

Illustration 2. Treatment of annuities under modification of the 3-percent rule

Assume an annuitant with a lifetime annuity of $1,000 for which he has paid $10,000, a life expectancy of 12 years and no income other than the annuity. If he could choose the portion of the payments to include and exclude from taxable income, he would choose to include

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1/ The percentage inclusion requirement might even be eliminated. This would amount to going back to the pre-1934 method under which annuity proceeds were excluded in their entirety until their total was equal to the consideration paid.

2/ If the option were available each year, the taxpayer could minimize his tax liability by changing the includible amount from year to year in accordance with his exemption status, allowable deductions and income from all sources.

$549 1/ in taxable income each year and exclude $451, thereby remaining nontaxable in each year. On this basis he could remain nontaxable for as long as 22 years. After 22 years the total amount excluded would be $9,922 leaving $78 of cost yet to be recovered tax-free. The 23rd year he would include $922 and exclude $78, becoming taxable for the first time. In subsequent years the entire $1,000 would be includible in gross income.

Assuming the same annuitant to have $550 2/ of other income, he would choose to include the minimum stipulated percentage of consideration, say $1\frac{1}{2}$ percent, or $150 in taxable income, excluding $850 annually for 11 years; in the 12th year he would include $350 and exclude $650; thereafter, the entire $1,000 would be included in taxable income for tax purposes.

The tax treatment of an illustrative employee annuity (1) under present law, (2) under the indicated modification of the 3-percent rule, and (3) under the life-expectancy method is compared below.

Illustration 3. Comparison of present law, modification of 3-percent rule and life-expectancy methods applicable to employee annuity

This table is based on the following assumptions: amount of employee annuity $900; no other income; employee's consideration $1,800; life expectancy 24 years; personal exemption and deductions of up to $550 of adjusted gross income under the present law Supplement T tax table.

Year	Present law			Modification of the 3-percent rule			Life-expectancy method		
	Amount included in taxable income	Amount excluded	Tax	Amount included in taxable income	Amount excluded	Tax	Amount included in taxable income	Amount excluded	Tax
1	$ 54	$ 846	0	$ 549	$ 351	0	$ 825	$ 75	$ 48
2	54	846	0	549	351	0	825	75	48
3	792	108	$ 40	549	351	0	825	75	48
4	900	0	61	549	351	0	825	75	48
5	900	0	61	549	351	0	825	75	48
6	900	0	61	855	45	$ 52	825	75	48
7	900	0	61	900	0	61	825	75	48
8-24	900	0	61	900	0	61	825	75	48
Total over 24 years	19,800	1,800	1,321	19,800	1,800	1,150	19,800	1,800	1,152

1/ The maximum amount of exempt income under the Supplement T tax table.
2/ The maximum taxable income under the Supplement T tax table.

b. Deduction for losses incurred by short-lived annuitants (mortality losses)

A criticism of both the 3-percent rule and the pre-1934 treatment is that these methods fail to provide tax adjustments for the losses of annuitants who die before receiving their entire consideration tax-free. Those making this criticism maintain that from the viewpoint of the annuitant, an annuity contract involves an element of chance associated with the relationship of the annuitant's actual life experience to his life expectancy; the annuitant whose life span falls short of his life expectancy suffers a loss, the chances of which are offset by the possibility of his life span exceeding his life expectancy. On the basis of this premise, they contend that mortality gains and losses should receive parallel tax treatment; that to the extent that no adjustments are made for the losses of short-lived annuitants, no taxes should be assessed against the gains of long-lived annuitants. The life-expectancy method attempts to meet this criticism on a group basis by not taxing mortality gains in full as an offset to the nonrecognition of mortality losses.

Proposals for a tax adjustment for losses of short-lived annuitants raise a number of considerations. If one regards an annuity contract as representing insurance against a certain type of contingency, namely, living so long that the individual's means become inadequate for his support, it may be considered that the annuitant receives security in return for his annuity outlay and that no real financial loss is involved in the event of premature death. 1/

A tax adjustment in the form of a loss deduction for annuitants' mortality losses in the year of the annuitant's death would in many instances be ineffective because the income for that year would be inadequate to absorb the entire loss. Therefore, to be fully effective the tax adjustment would need to provide for carryback of losses to preceding years and appropriate refunds. Such procedure would involve serious administrative difficulties. The question is also raised as to how the loss should be determined. One approach would be to define the loss as the amount of the consideration paid for the annuity which has not yet been excluded for income tax purposes. This approach introduces a complete symmetry in the tax treatment of gains and losses where the gains are fully taxable. Another approach would be to define the loss deduction as the amount of consideration not yet excluded tax-free, but not in excess of the amount of annuity income included for tax purposes. This approach would tend to limit the tax benefit from such deduction to the amount of tax liability attributable to the inclusion of a portion of the annuity in taxable income.

1/ This reasoning underlies the present ruling that mortality losses under annuity contracts are not deductible. See I.T. 2915, op. cit.; Walter D. Freyburger, "Income Tax on Annuity Payments," Taxes, Vol. 24, No. 9 (Sept. 1946), p. 862; Robert Meisenholder, "Taxation of Annuity Contracts Under Federal Income Tax," Michigan Law Review, Vol. 40 (May 1942), p. 1017.

Finally, tax adjustments for losses suffered by short-lived annuitants would be of no direct benefit to the annuitant during his lifetime. Instead, the benefit would accrue to his estate. This would be an important consideration to many annuitants, who were concerned with the financial security of survivors. For others, however, this type of adjustment would be less satisfactory than some other method which would be of actual benefit to the annuitant during his lifetime.

Maximum protection against taxing return of capital during the lifetime of the annuitant would be provided under the pre-1934 method, modified to ensure tax benefit for exclusions. However, this has the defect of abruptly increasing the taxable portion of an annuity and in some instances of reducing appreciably (by the amount of the tax) the amount of income available for meeting living expenses after capital is recovered. 1/ Many annuitants might feel they should anticipate this development by putting aside a portion of their annuity during earlier years. To this extent, the pre-1934 method of exempting all annuity payments until consideration was recovered would not afford real relief even to the short-lived annuitant.

3. Reserve-earnings approach

A third general method of determining the taxable element in annuity income would be to impute to the annuitant each year an amount of income equal to the interest earned on the calculated reserve behind his annuity. In general, such reserve, calculated in accordance with established actuarial standards, corresponds at any given time to each annuitant's pro rata share of the aggregate capital remaining as a reserve behind a group of annuity contracts. This method would amount to treating annuity payments somewhat like a series of withdrawals from a bank account, consisting partly of principal and partly of interest on the declining balance. It would involve the inclusion of a high portion of the payments and a low rate of exclusion for capital recovery during the early years of the annuity, with a gradual decrease of the portion included in income as the annuitant grew older. This method is regarded by some observers as the fairest way of determining for tax purposes the income element under annuity investments. 2/

1/ It should be noted, however, that a modification allowing annuitants to slow up the rate of annual exclusion to ensure tax benefit would, in many instances where the taxpayer's income is low, postpone the time when the annuity became taxable beyond normal life expectancy. See Illustration 2, above.

2/ John S. Thompson, "Income Tax on Annuities," Transactions, Actuarial Society of America, May 1915, Vol. XVI, Part I, No. 53, pp. 95-108. Also William Vickrey, Agenda for Progressive Taxation, Ronald Press, New York, 1947, pp. 77-78.

The reserve-earnings method would provide a correct over-all measurement of the income element under annuities. If this method were followed literally, gains of long-lived annuitants would tend to be excluded from taxable income, since the reserve on which the income element is computed would be smaller the longer the annuitant lived. Where the annuitant lived substantially beyond his normal expectancy, a very low portion of income would be included. 1/ However, it would be possible to modify this by requiring the full inclusion of payments in taxable income after consideration was recovered. This modification is subject to the criticism that it would result in an abrupt increase in the taxable portion of annuity income as under the 3-percent rule. In the absence of a provision for a tax adjustment to short-lived annuitants, those who died prematurely would be treated less favorably under the reserve-earnings method than under the life-expectancy method, since the former would result in a higher taxable amount during the early years payments were received. This treatment may be viewed as avoiding postponement of income realization for tax purposes which may be said to occur under the life-expectancy method.

Compliance and administration problems under the reserve-earnings method would appear to be serious but not insurmountable. The task of actuarial analysis for purposes of measuring income and return of principal would be substantially more difficult under the reserve-earnings method than under the life-expectancy method, especially in the case of more complicated types of contracts. Moreover, in the case of deferred annuities and employee annuities, the problem of determining an equitable and practicable method of treating deferred wages and accrued interest would be particularly difficult. The rationale of this method would not be readily comprehensible to most taxpayers. Since the taxable income portion of a given annuity would vary from year to year under the reserve-earnings method, it would be necessary to provide adequate information to the taxpayer with respect to the amount of annuity income he should report for tax purposes each successive year. This might be done either by an annual information return which the payer of the annuity would send the annuitant, or by providing the taxpayer with a schedule of amounts to be reported year by year, analogous, for example, to the schedule of interest accruals, under a Series E United States savings bond or a schedule of redemption values shown in a life insurance policy contract.

4. <u>Transition problems</u>

If the present treatment of annuities were changed, questions would arise with regard to the transitional treatment of annuities which have been subject to the 3-percent rule. Possible alternative transition methods for various types of annuities are briefly described below:

a. <u>Limit the new method to annuities becoming effective in the future</u>

This approach would afford no relief to existing annuitants for inadequate treatment received under the 3-percent rule. However, it

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1/ Thompson, "Income Tax on Annuities," *op. cit.*, p. 105.

might be justified under the life-expectancy method in order to avoid windfalls in the form of tax-free exclusions. If the 3-percent rule were merely modified to 1 or $1\frac{1}{2}$ percent, it would not be necessary to restrict its application to future annuities since such a change could be applied to existing annuities without a windfall problem.

b. Treat existing annuities as though they had been subject to the new method from the beginning

This approach would provide to all annuitants the benefits of the new method with respect to current payments. It would tend to give windfall exclusions to some annuitants who had already recovered all or a substantial part of their principal tax-free, since the aggregate amount of their tax-free recovery would exceed the consideration paid. However, other annuitants such as those with immediate annuities, would not get a retroactive adjustment for past inadequate tax-free exclusions of capital.

c. Allow annuitants to use the new method provided they recompute their tax on the new basis for previous years

Such a transition provision would afford both current and retroactive relief for defects of the 3-percent rule under any of the alternative methods for treating annuities. Although it would avoid windfalls, it would entail serious compliance and administrative burdens in connection with the reopening of previous years' returns. It would be difficult to apply to years when no return was filed and, in addition, tax refunds would be involved.

d. Apply the new method to existing annuities using the amount of consideration not already excluded from gross income as the cost basis for the future

Under both the life-expectancy and the modification of the 3-percent-rule methods, this type of transition would accord considerable relief to annuitants who found the present exclusion rate either inadequate or excessive. However, it would not accord retroactive relief to taxpayers who had failed to obtain tax benefit for previous exclusions. It would avoid windfall exclusions in excess of consideration paid during the period of life expectancy.

B. Treatment of social security old-age and survivors' insurance and railroad retirement benefits

The Treasury Department has recommended that social security old-age and survivors' insurance and railroad retirement benefits be included in income subject to the generally applicable revenue laws. 1/ This change

1/ See letter from the Secretary of the Treasury to the Chairman of the Ways and Means Committee, September 21, 1945, published in the Congressional Record, September 25, 1945, p. 9137. See also the statement by Tax Legislative Counsel, U. S. Treasury Department, in Tax Exemption of Annuity Payments under Civil Service Retirement, Hearings before the Committee on Finance, U. S. Senate, 79th Cong., 2nd Sess., on H.R. 2948, p. 23.

is recommended both to provide equal treatment for similarly situated annuitants and to avoid the extension of special exemptions to other pension and annuity groups.

In the event that social security and railroad retirement pension exemptions were removed, the question would be raised as to the proper determination of the income portion of the pension payments. Nominally a tax, the employee's payroll tax contribution is essentially similar in character to employee contributions under private industrial pension plans. 1/ It would, therefore, appear discriminatory to include the entire benefit in income when received without allowing the recipient an equivalent to the exemption of return of contributions which he would enjoy under other retirement pension plans. 2/ Possible methods of treating social security and railroad retirement employee payroll tax in the event the pensions were included in gross income are discussed below. 3/

Method (1). Compute the employee's total contributions from the retirement account records; treat this amount as the purchase price of his annuity; and apply the regular capital-recovery provisions to such computed consideration.

Method (2). Assign a reasonable amount as the employee's total contributions in some proportion to his annuity without reference to individual retirement account records, and treat this amount as the purchase price of his annuity, to which the regular capital-recovery provisions would be applied.

Method (3). Exclude some appropriate percentage of each pension payment as a rough allowance for the tax-free return of contributions paid.

Method (4). Exempt the pension in its entirety for one or more years as a rough approximation to exempting the return of contributions paid, after which pension payments would be fully included in taxable income.

1/ It may be argued, however, that the employee tax is not actually borne by the employee but shifted to the employer or consumers. This is uncertain, and in any event, shifting of the employee's cost may also occur under contributory private retirement plans. Moreover, lack of close correspondence between the amounts of individual employees' contributions and benefits may occur under private retirement plans as well as under social security and railroad retirement. Such considerations would not seem to justify failure to allow for tax-free recovery of employee contributions.

2/ The amounts involved are more important under railroad retirement than under social security old-age and survivors' insurance.

3/ Different methods of treatment might be applied with respect to social security as compared with railroad retirement. Moreover, a re-examination of methods of tax treatment might be called for in the event of a basic revision of social security or railroad retirement provisions.

Method (5). Allow the payroll tax contribution as a current deduction or exclusion 1/ from the income of the employee and make the pension fully includible in income when subsequently received.

Method (1) would require determining and notifying the taxpayer of his aggregate contributions according to the retirement account records. This may involve compliance or administrative burdens which could be avoided under the other methods. Both Methods (1) and (2) would require the application of the regular annuity provisions. Methods (3) and (4) would be simple but rough methods of allowing tax-free return of contributions. Method (4) would be subject to the criticism that it would result in wastage of the exclusion, like the present 3-percent annuity rule, in the case of low-income recipients.

Method (5) would constitute a sharp break with existing and previous law since it would allow the current deduction or exclusion of a savings item. While such treatment is implicitly allowed in the case of the current noninclusion of employer payroll tax contributions under social security and railroad retirement as well as employer contributions under qualified pension plans, its explicit application to employee payroll tax contributions would raise basic issues regarding the character of the income tax base and might serve as a precedent for similar treatment for all employee contributions and other current savings items. Since this treatment would require the full amounts of the pension payments, including return of savings, to be reported as income when received in later years, it would not be equivalent to exempting savings. 2/ However, the resulting re-allocation of taxable income from a current to a future period would tend to shift earnings from peak income years to low-income years, raising issues connected with averaging of income for tax purposes. In contrast with the other methods mentioned, it would involve a net revenue loss. The following table summarizes estimates indicating that the current exclusion of employee payroll tax contributions to social security old-age and survivors' insurance and railroad retirement funds would involve net revenue losses of $111 million and $263 million in 1947 and 1957, in excess of the revenue increases due to including benefits in taxable income.

1/ As an exclusion, it would automatically fall outside the standard deduction. As a deduction, it would come under the standard deduction unless specifically made deductible in arriving at adjusted gross income.

2/ The problems and issues pertaining to the tax treatment of various types of saving will be analyzed in another Treasury study. See statement of the Secretary of the Treasury before the Ways and Means Committee of the House of Representatives, May 19, 1947, p. 10.

Estimated revenue effects of including social security old-age and survivors' insurance and railroad retirement benefits in taxable income and excluding employee payroll tax contributions from taxable income, calendar years 1947 and 1957 a/

	Calendar years	
	1947	1957
	(Millions)	
Increase in revenue from including in taxable income:		
Social security old-age and survivors' insurance benefits	$ 23	$ 75
Railroad retirement benefits	10	15
Total increase	33	90
Decrease in revenue from excluding from taxable income employee contributions to:		
Social security old-age and survivors' insurance	103	308
Railroad retirement	41	45
Total decrease	144	353
Net decrease	$111	$263

a/ These estimates assume tax rates and exemptions under the Internal Revenue Code, as amended by the Revenue Act of 1945. They were prepared in early summer of 1947 on the basis of the unrevised national income series of the Department of Commerce. For the statistical and conceptual differences between this series and the new series on "personal income," see National Income Supplement to the Survey of Current Business, July 1947.

C. Treatment of lump-sum receipts

1. Capital gains treatment

Long-term capital gains treatment applicable to a single annual settlement of an employee's rights under a qualified pension trust raises questions of tax avoidance and equity. One approach which is concerned with precluding possible abuses would be to restrict capital gains treatment to cases (for example, separation by death) where the employee or his family had no alternative but to receive a lump-sum distribution. That is, for purposes of plugging potential loopholes, the case for capital gains treatment might be re-examined where the employee voluntarily quits employment and voluntarily takes an option to receive a lump-sum settlement of his pension fund rights.

Another suggestion which merits further study is the possibility of substituting some form of averaging for the capital gains treatment now applicable to such pension trust distributions. Under Canadian law, for example, lump-sum retirement settlements paid after June 28, 1946 may at the option of the taxpayer be taxed as a separate item of income in the year received, subject to the average rate of tax applicable to his income of the previous year. 1/

Whatever the inherent merits of capital gains treatment where now applicable to retirement benefits, its limitation to distributions under trusteed plans raises questions of equity with respect to the treatment of recipients of lump-sum payments under non-trusteed plans who appear to have equal claim for relief from the application of progressive rates. Moreover, the present income tax treatment of survivor refunds may be held to discriminate against those which do not classify as life insurance proceeds in comparison with substantively similar payments to survivors which qualify as tax-exempt life insurance proceeds paid by reason of death of the insured.

2. Treatment of purchase of single-premium annuity outside qualified plan

As noted above, proposals which would allow employee annuities purchased outside a qualified plan to be taxed only as received, while allowing the purchase price as a deduction to the employer would virtually remove the present law sanctions against unqualified plans. Consequently, it is difficult to find an alternative solution which would avoid hardship in bona fide cases without creating serious avoidance opportunities.

One possible alternative would be the application of some averaging device (such as the Canadian averaging provision previously noted or the Section 107 provision) to the value of annuity contracts vested in the employee. Another approach would be to allow the employee to include the annuity payments in his taxable income as received, but require

1/ See Appendix B.

the spreading of the deduction of the cost of such annuity contracts to the employer over the years the annuity is paid and taxed to the employee. While this approach would obviate the tax avoidance problems involved in allowing employers to time their deductions for the cost of such contracts so as to coincide with particular years of high income or high tax rates, it would have serious tax avoidance aspects since it would confer substantial tax savings in the nature of an effective averaging device of special importance to highly paid employees.

D. Installment payment of life insurance proceeds paid by reason of death of the insured

Under equal tax treatment for income derived from annuity and insurance policies, installment payments of life insurance proceeds would be treated as an annuity for which the consideration would be deemed to be the lump sum payable to the beneficiary or the commuted value of the installment payment rights at the time of the death of the insured.

E. Deferred annuity contracts

Savings invested through annuity contracts sold by life insurance companies or through retirement pension plans receive preferential treatment compared with savings placed in private interest-bearing securities and in most Federal securities in that the accrued earnings are not currently included in taxable income. While the tax savings involved in most individual cases are small and may be regarded as a form of subsidy to savings for old age, the use of deferred annuity investments on a large scale would go beyond this purpose. If tax avoidance through deferred annuities either became, or were regarded as a serious problem, a possible solution would be to limit the amount of money invested by any individual in deferred annuities on which interest accruals could be currently excluded from taxable income. Interest on amounts in excess of this limit would then be currently included in taxable income and tax-free recovery of such interest would be allowed by adding it to the cost basis of the contract.

F. Comparative treatment of contributory and noncontributory pensions

The present treatment of employer contributions under retirement plans involves broad questions of equity in that the current exclusion from the employee's taxable income of the employer contribution, especially when vested in the employee, is an exception to the general rule that the Federal income tax applies to all net income actually and constructively received. Although the employer contributions are subsequently included in taxable income of retired employees, the present treatment favors the recipients of employer-financed benefits and tends to encourage the development of plans on a noncontributory basis. In addition, broad economic and social considerations are also involved respecting the tax treatment of basic retirement savings.

There are several alternative methods of income tax treatment of contributory and noncontributory pensions which would place them on a comparable basis. One possibility would be to include employer contributions in the employee's income for tax purposes. This would be unfair where vesting in the employee is inadequate to warrant current taxation. Such inequities might be avoided by making full vesting of benefits a requirement for qualified plans. This approach would increase individual income tax liabilities for employees under qualified retirement plans, and would remove a substantial part of the present favorable treatment accorded such plans.

It has also been proposed that employee contributions to pension plans be deducted currently and that the benefits be fully included in gross income when received. 1/ Current deduction of employee contributions would involve substantial revenue losses. Moreover, the current deduction of employee retirement contributions would tend to call for similar tax treatment of other savings items which would involve a basic change in the annual taxable income concept, to net income less some portion of savings. 2/ This treatment would avoid the problems dealt with of various provisions of present law relating to the taxability by employer contributions to the employee. It would also avoid the problem of allowing tax-free return of capital for a broad class of annuities. Moreover, it would provide a greater degree of tax encouragement for systematic provision for old-age retirement. To the extent that currently deductible savings were subsequently taxable in full, such treatment would not decrease the total income taxable to the employee during his lifetime; rather it would reallocate his income among taxable years. Consequently, it would raise questions relating to the averaging of income for tax purposes. Since such limited application of averaging would be of benefit only to employees, it would constitute special treatment of a certain class of earned income.

G. Other considerations

In a comprehensive revision of the annuity provisions, one objective would be to minimize the area of uncertainty in the definition and treatment of annuities.

1/ See Report Proposing Amendments to Federal Income, Estate, and Gift Tax Laws, Committee on Taxation, Trust Division, American Bankers Association, January 1946, pp. 6-7 and 23-24. It may be noted that under recently adopted Canadian policy, employee contributions to pension plans up to $900 a year are currently excluded from individual income tax, the payments being taxable when received. See Appendix B.

2/ Various proposals have also been made to allow self-employed persons (or employees not covered under organized retirement plans) to deduct specified amounts of their current earnings if set aside as a personal retirement fund, possibly through investment in a special issue of Government bonds. Such investments, including accumulated interest, would then be included in gross income when converted into cash, presumably after retirement. See, for example, Harry Silverson, "A New Tax Proposal," American Mercury, March 1947, pp. 345-349. It has already been noted that the problems and issues pertaining to the deduction of various types of savings will be analyzed in another Treasury study.

The treatment of disability retirement pay of regular Army and Navy personnel as compared with ordinary military retirement pay should be re-examined. If it is considered desirable to place such payments on a more comparable basis with ordinary military retirement pay, one method of achieving this result would be to restrict the amounts exempted under Section 22(b)(5) to the proportion of disability retirement payments which represents the degree of actual disability for purposes of civilian employment.

Another objective in resurveying the disability payment provisions would be clarification, with a view to removing some of the uncertainties and apparent anomalies encountered under present law with particular reference to disabled municipal and public employees. This may be one of the motives behind some recent proposals designed to broaden the scope of the existing exemption of disability payments. However, liberalization of the disability provisions in the civilian area may introduce problems analogous to those found in the field of military disability retirement payments.

APPENDIX A

Tables 1 - 9

Table 1

Annuities reported on taxable and nontaxable returns with net income, 1941, by net income classes; also aggregates for individual returns with no net income

(Net income classes and money figures excepting averages in thousands)

Net income classes	Total number of returns	Total income	Annuities: Number of returns	Annuities: Percentage of total returns	Annuities: Amount	Annuities: Percentage of total income	Annuities: Average annuity income per return reporting such income
Returns with net income:							
Form 1040A 1/ (est.)	10,252,708	$17,531,107	2/	2/	2/	2/	2/
Form 1040:							
Under $5 (est.)	14,581,121	33,261,799	2/	2/	$130,707	.39%	2/
5 " 10	630,105	4,869,143	14,263	2.26%	13,351	.28	$ 936
10 " 25	238,880	4,068,619	7,369	3.08	9,814	.24	1,332
25 " 50	48,157	1,878,735	1,976	4.10	4,058	.22	2,054
50 " 100	14,365	1,112,017	741	5.16	2,384	.22	3,217
100 " 150	2,664	370,610	171	6.42	573	.16	3,351
150 " 300	1,539	358,978	129	8.38	511	.14	3,961
300 " 500	348	154,080	31	8.91	262	.17	8,452
500 " 1,000	152	120,806	8	5.26	64	.05	8,000
1,000 and over	50	115,153	7	14.00	127	.11	18,143
5 and over	936,260	13,048,141	24,695	2.64	31,143	.24	1,261
Total, Form 1040 A and Form 1040 with net income	25,770,089	63,841,047	2/	2/	2/	2/	2/
Returns with no net income, Form 1040	99,828	264,032	2,462	2.47	2,157	.82	876
Grand total	25,869,917	64,105,079	2/	2/	2/	2/	2/
Total, Form 1040A	10,252,708	17,531,107	2/	2/	2/	2/	2/
Total, Form 1040	15,617,209	46,573,972	2/	2/	2/	2/	2/

Treasury Department, Division of Tax Research

1/ Form 1040A (optional return), which may be filed by individuals whose gross income is from certain sources only and is not more than $3,500, does not provide for reporting the amount of net income. Gross income is tabulated both as total income and as net income.

2/ Not available.

Source: Based on Statistics of Income for 1941, Part 1, Table 7-A.

Table 2

Annuities reported on individual returns with net income, 1941, by taxable and nontaxable returns, and by net income classes; also aggregates for taxable and nontaxable individual returns with no net income

(Net income classes and money figures excepting averages in thousands)

Net income classes	Total number of returns	Total income: Amount	Total income: Percentage distribution	Annuities: Number of returns 1/	Annuities: Amount	Annuities: Percentage distribution	Annuities: Average annuity income per return reporting such income 1/	Annuities: Average annuity income per return for all returns
Taxable returns:								
With net income:								
Form 1040A 2/ (est.)	6,199,542	$ 10,560,017	16.5%	3/	3/	3/	3/	3/
Form 1040:								
Under $0.75 (est.)	35,917	22,589	*	1/	$ 226	.1%	1/	$ 6
0.75 " 1 (est.)	757,627	757,924	1.2	1/	8,511	5.2	1/	11
1 " 1.5 (est.)	1,281,524	1,772,579	2.8	1/	15,630	9.5	1/	12
1.5 " 2 (est.)	2,121,571	4,189,981	6.5	1/	19,748	12.1	1/	9
2 " 2.5 (est.)	2,317,362	5,757,306	9.0	1/	15,367	9.4	1/	7
2.5 " 3 (est.)	1,694,737	5,127,776	8.0	1/	13,092	8.0	1/	8
3 " 4 (est.)	1,643,774	6,169,484	9.6	1/	16,757	10.2	1/	10
4 " 5 (est.)	514,273	2,561,167	4.0	1/	9,475	5.8	1/	18
5 " 6	249,078	1,551,983	2.4	5,078	4,123	2.5	$ 811	17
6 " 7	150,324	1,115,968	1.7	3,374	3,055	1.9	905	20
7 " 8	102,440	880,869	1.4	2,485	2,471	1.5	994	24
8 " 9	72,278	708,595	1.1	1,926	2,121	1.3	1,101	29
9 " 10	55,985	611,727	1.0	1,400	1,583	1.0	1,131	28
10 " 11	42,757	516,924	.8	1,175	1,282	.8	1,091	30
11 " 12	34,072	452,118	.7	927	1,045	.6	1,127	31
12 " 13	27,374	395,365	.6	871	980	.6	1,125	36
13 " 14	22,776	355,095	.6	715	1,041	.6	1,456	46
14 " 15	19,134	319,353	.5	549	680	.4	1,240	36
15 " 20	61,158	1,216,075	1.9	2,010	2,844	1.7	1,415	47
20 " 25	31,609	813,689	1.3	1,122	1,943	1.2	1,732	61
25 " 30	18,384	580,177	.9	681	1,186	.7	1,742	65
30 " 40	19,785	783,570	1.2	797	1,528	.9	1,917	77
40 " 50	9,988	514,988	.8	498	1,344	.8	2,699	135
50 " 60	5,733	362,318	.6	258	520	.3	2,016	91
60 " 70	3,541	265,086	.4	199	895	.5	4,497	253
70 " 80	2,307	198,961	.3	124	407	.2	3,282	176
80 " 90	1,606	157,189	.2	91	300	.2	3,297	187
90 " 100	1,178	128,462	.2	69	262	.2	3,797	222
100 " 150	2,664	370,610	.6	171	573	.3	3,351	215
150 " 200	922	184,593	.3	75	249	.2	3,320	270
200 " 250	408	106,996	.2	33	92	.1	2,788	225
250 " 300	209	67,389	.1	21	171	.1	8,143	818
300 " 400	229	92,258	.1	20	241	.1	12,050	1,052
400 " 500	119	61,822	.1	11	21	*	1,909	176
500 " 750	104	73,189	.1	6	19	*	3,167	183
750 " 1,000	48	47,617	.1	2	45	*	22,500	938
1,000" 1,500	30	45,395	.1	5	62	*	12,400	2,067
1,500" 2,000	4	7,997	*	-	-	-	-	-
2,000" 3,000	9	23,732	*	2	64	*	32,000	7,111
3,000" 4,000	5	24,223	*	-	-	-	-	-
4,000" 5,000	-	-	-	-	-	-	-	-
5,000 and over	2	13,806	*	-	-	-	-	-
Total, returns with net income	17,502,587	49,966,963	77.9	24,695 4/	129,949	79.2	1,261 4/	11 5/
With no net income, Form 1040	297	30,031	*	29	121	.1	4,172	407
Total, taxable returns	17,502,884	49,996,993	78.0	24,724 4/	130,071	79.3	1,265 4/	12 5/
Nontaxable returns:								
With net income:								
Form 1040A 2/ (est.)	4,053,166	6,971,090	10.9	3/	3/	3/	3/	3/
Form 1040:								
Under 0.75 (est.)	858,153	706,443	1.1	1/	11,415	7.0	1/	13
0.75 " 1 (est.)	284,504	315,091	.5	1/	2,810	1.7	1/	10
1 " 1.5 (est.)	1,309,494	1,999,381	3.2	1/	13,023	7.9	1/	10
1.5 " 2 (est.)	1,024,992	1,999,639	3.1	1/	3,066	1.9	1/	3
2 " 2.5 (est.)	553,386	1,332,527	2.1	1/	941	.6	1/	2
2.5 " 3 (est.)	149,629	431,334	.7	1/	540	.3	1/	4
3 " 4	33,119	113,748	.2	1/	100	.1	1/	3
4 " 5	1,059	4,829	*	1/	4	*	1/	4
Total, returns with net income	8,267,502	13,874,084	21.6	1/	31,901	19.5	1/	8 5/
With no net income, Form 1040	99,531	234,002	.4	2,433	2,035	1.2	836	20
Total, nontaxable returns	8,367,033	14,108,086	22.0	2,433 4/	33,936	20.7	3/	8 5/
Grand total	25,869,917	64,105,079	100.0	27,157 4/	164,006	100.0	3/	11 5/
Total, Form 1040A	10,252,708	17,531,107	27.3	3/	3/	3/	3/	3/
Total, Form 1040	15,617,209	46,573,973	72.7	27,157 4/	164,006	100.0	1,265 4/	11

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1/ The number of returns with net income under $5,000 reporting annuities is not available.
2/ Form 1040A (optional return), which may be filed by individuals whose gross income is from certain sources only and is not more than $3,000, does not provide for reporting the amount of net income. Gross income is tabulated both as total income and as net income.
3/ Not available.
4/ Excludes Form 1040A and Form 1040 returns with net income under $5,000.
5/ Excludes 1040A returns.
* Less than 0.05 percent.

Source: Adapted from Statistics of Income for 1941, Part 1, Table 7-A.

Table 3

Annuities reported on individual returns, Form 1040, with net income and with no net income, 1941, by States and Territories

(Money figures in thousands of dollars)

States and Territories	Total income: Returns with net income	Total income: Returns with no net income	Total income: All returns	Annuities: Returns with net income	Annuities: Returns with no net income	Annuities: All returns	Annuities as percentage of total income: Returns with net income	Annuities as percentage of total income: Returns with no net income	Annuities as percentage of total income: All returns	Percentage distribution: Total income	Percentage distribution: Annuities
Alabama	$ 329,080	$ 996	$ 330,076	$ 474	$ 4	$ 478	.1%	.4%	.1%	.7%	.3%
Alaska	37,990	234	38,224	57	*	57	.2	**	.2	.1	**
Arizona	116,435	1,082	117,517	560	17	577	.5	1.6	.5	.3	.4
Arkansas	214,140	645	214,785	603	7	610	.3	1.1	.3	.5	.4
California	3,522,077	28,522	3,550,599	22,327	251	22,578	.6	.9	.6	7.6	13.8
Colorado	326,962	1,527	328,489	2,819	20	2,839	.9	1.3	.9	.7	1.7
Connecticut	968,714	5,938	974,652	3,335	24	3,359	.3	.4	.3	2.1	2.0
Delaware	161,119	2,884	164,003	542	27	569	.3	.9	.3	.4	.3
District of Columbia	421,974	858	422,832	2,787	2	2,789	.7	.2	.7	.9	1.7
Florida	525,882	6,901	532,783	2,520	77	2,597	.5	1.1	.5	1.1	1.6
Georgia	464,660	2,572	467,232	1,047	35	1,082	.2	1.4	.2	1.0	.7
Hawaii	114,332	113	114,445	214	-	214	.2	-	.2	.2	.1
Idaho	122,376	560	122,936	197	3	200	.2	.5	.2	.3	.1
Illinois	3,654,955	16,886	3,671,841	14,903	104	15,007	.4	.6	.4	7.9	9.2
Indiana	1,136,508	3,185	1,139,693	4,282	27	4,309	.4	.8	.4	2.4	2.6
Iowa	749,628	1,992	751,620	1,888	20	1,908	.3	1.0	.3	1.6	1.2
Kansas	463,734	2,230	465,964	1,581	18	1,599	.3	.8	.3	1.0	1.0
Kentucky	454,507	1,631	456,138	1,046	11	1,057	.2	.7	.2	1.0	.6
Louisiana	395,628	2,764	398,392	1,238	10	1,248	.3	.4	.3	.9	.8
Maine	228,187	2,195	230,382	638	22	660	.3	1.0	.3	.5	.4
Maryland	929,757	2,281	932,038	1,777	19	1,798	.2	.8	.2	2.0	1.1
Massachusetts	1,936,702	14,847	1,951,549	8,753	104	8,857	.5	.7	.5	4.2	5.4
Michigan	2,468,325	5,893	2,474,218	3,825	51	3,876	.2	.9	.2	5.3	2.4
Minnesota	884,067	2,615	886,682	2,661	25	2,686	.3	1.0	.3	1.9	1.6
Mississippi	186,872	459	187,331	328	3	331	.2	.7	.2	.4	.2
Missouri	1,159,861	5,824	1,165,685	3,669	108	3,777	.3	1.9	.3	2.5	2.3
Montana	173,723	800	174,523	404	3	407	.2	.4	.2	.4	.2
Nebraska	307,631	1,779	309,410	710	11	721	.2	5.7	.2	.7	.4
Nevada	56,479	627	57,106	230	36	266	.4	.6	.5	.1	.2
New Hampshire	151,512	940	152,452	521	10	531	.3	1.1	.3	.3	.3
New Jersey	2,366,054	9,710	2,375,764	7,195	78	7,273	.3	.8	.3	5.1	4.4
New Mexico	94,448	470	94,918	199	12	211	.2	2.6	.2	.2	.1
New York	7,334,537	77,734	7,412,271	27,930	423	28,353	.4	.5	.4	15.9	17.4
North Carolina	480,486	810	481,296	939	2	941	.2	.2	.2	1.0	.6
North Dakota	144,015	334	144,349	440	5	445	.3	1.5	.3	.3	.3
Ohio	3,043,204	12,099	3,055,303	10,311	90	10,401	.3	.7	.3	6.6	6.3
Oklahoma	430,696	3,040	433,736	1,033	32	1,065	.2	1.1	.2	.9	.6
Oregon	389,566	1,629	391,195	1,182	29	1,211	.3	1.8	.3	.8	.7
Pennsylvania	3,753,120	15,610	3,768,730	10,551	117	10,668	.3	.7	.3	8.1	6.5
Rhode Island	340,471	1,526	341,997	1,258	1	1,259	.4	.1	.4	.7	.8
South Carolina	208,807	813	209,620	470	135	605	.2	16.6	.3	.5	.4
South Dakota	127,199	472	127,671	272	8	280	.2	1.7	.2	.3	.2
Tennessee	467,080	1,573	468,653	1,138	7	1,145	.2	.4	.2	1.0	.7
Texas	1,548,490	11,512	1,560,002	2,643	112	2,755	.2	1.0	.2	3.3	1.7
Utah	132,099	4	132,103	266	-	266	.2	-	.2	.3	.2
Vermont	92,866	146	93,012	773	-	773	.8	-	.8	.2	.5
Virginia	634,864	1,757	636,621	996	22	1,018	.2	1.3	.2	1.4	.6
Washington	639,729	2,685	642,414	2,835	22	2,857	.4	.8	.4	1.4	1.7
West Virginia	337,587	785	338,372	1,026	5	1,031	.3	.6	.3	.7	.6
Wisconsin	994,308	1,186	995,494	4,261	4	4,265	.4	.3	.4	2.1	2.6
Wyoming	86,496	357	86,853	195	2	197	.2	.6	.2	.2	.1
Total individual returns, Form 1040	46,309,940	264,032	46,573,972	161,850	2,157	164,007	.3	.8	.4	100.0	100.0

Treasury Department, Division of Tax Research

* Less than $500.
** Less than .05 percent.

Source: Adapted from Statistics of Income for 1941, Part I, Table 6.

Table 4

Annuities reported on individual returns with net income, 1942, by taxable and nontaxable returns, and by net income classes; also aggregates for individuals returns with no net income

(Net income classes and money figures in thousands)

Net income classes	Total income	Annuities		
		Amount	Percentage of total income	Percentage distribution
Taxable returns with net income:				
Form 1040A 1/ (est.)	$18,535,476	2/	2/	2/
Form 1040:				
Under $0.5 (est.)	34,930	$ 162	.46%	.11%
0.5 " 0.75 (est.)	601,848	5,330	.89	3.78
0.75 " 1 (est.)	857,614	7,036	.82	4.99
1 " 1.25 (est.)	1,068,140	7,570	.71	5.37
1.25 " 1.5 (est.)	1,978,867	10,340	.52	7.34
1.5 " 1.75 (est.)	2,753,055	9,249	.34	6.56
1.75 " 2 (est.)	3,411,475	7,190	.21	5.10
2 " 2.25 (est.)	3,787,671	5,948	.16	4.22
2.25 " 2.5 (est.)	3,734,015	4,988	.13	3.54
2.5 " 2.75 (est.)	3,380,826	3,552	.10	2.52
2.75 " 3 (est.)	3,438,676	4,133	.12	2.93
3 " 3.5 (est.)	5,975,035	6,560	.11	4.66
3.5 " 4 (est.)	3,703,133	4,114	.11	2.92
4 " 4.5 (est.)	2,321,650	3,772	.16	2.68
4.5 " 5 (est.)	1,609,923	3,264	.20	2.32
5 " 6	1,960,626	3,930	.20	2.79
6 " 7	1,322,126	3,095	.23	2.20
7 " 8	1,020,859	2,349	.23	1.67
8 " 9	826,659	2,082	.25	1.48
9 " 10	713,792	1,593	.22	1.13
10 " 11	608,431	1,346	.22	.96
11 " 12	534,568	1,263	.24	.90
12 " 13	471,382	1,105	.23	.78
13 " 14	421,211	825	.20	.59
14 " 15	384,693	762	.20	.54
15 " 20	1,477,163	3,184	.22	2.26
20 " 25	1,012,704	2,131	.21	1.51
25 " 30	741,733	1,495	.20	1.06
30 " 40	995,651	1,895	.19	1.34
40 " 50	664,105	1,401	.21	.99
50 " 60	472,114	813	.17	.58
60 " 70	340,728	660	.19	.47
70 " 80	260,507	324	.12	.23
80 " 90	202,158	430	.21	.31
90 " 100	165,979	212	.13	.15
100 " 150	466,684	854	.18	.61
150 " 200	217,606	188	.09	.13
200 " 250	129,227	144	.11	.10
250 " 300	81,984	198	.24	.14
300 " 400	95,602	57	.06	.04
400 " 500	71,511	110	.15	.08
500 " 750	93,104	52	.06	.04
750 " 1,000	47,977	45	.09	.03
1,000" 1,500	25,391	62	.24	.04
1,500" 2,000	14,966	-	-	-
2,000" 3,000	8,789	2	.02	*
3,000" 4,000	3,613	-	-	-
4,000" 5,000	26,202	-	-	-
5,000 and over	11,731	-	-	-
Total, taxable returns	73,083,908	115,812	.16	82.19
Nontaxable returns:				
With net income:				
Form 1040A 1/ (est.)	7,180,498	2/	2/	2/
Form 1040:				
Under 0.5 (est.)	479,968	6,854	1.43	4.86
0.5 " 0.75 (est.)	266,566	1,772	.66	1.26
0.75 " 1 (est.)	547,580	3,094	.57	2.20
1 " 1.25 (est.)	1,190,743	7,288	.61	5.17
1.25 " 1.5 (est.)	820,959	1,698	.21	1.21
1.5 " 1.75 (est.)	758,022	1,017	.13	.72
1.75 " 2 (est.)	705,244	624	.09	.44
2 " 2.25 (est.)	409,450	221	.05	.16
2.25 " 2.5 (est.)	144,240	68	.05	.05
2.5 " 2.75 (est.)	122,169	25	.02	.02
2.75 " 3 (est.)	74,643	*	*	**
3 " 3.5 (est.)	71,160	78	.11	.06
3.5 " 4 (est.)	17,282	-	-	-
4 " 4.5 (est.)	2,786	-	-	-
4.5 " 5 (est.)	898	-	-	-
Total, nontaxable returns with net income	12,792,210	22,738	.18	16.15
With no net income, Form 1040 (est.)	181,486	2,362	1.30	1.68
Total, nontaxable returns	12,973,696	25,099	.19	17.81
Grand total	86,057,604	140,911	.16	100.00
Total, Forms 1040A	25,715,974	2/	2/	2/
Total, Forms 1040	60,341,630	140,911	.16	100.00

Treasury Department, Division of Tax Research

1/ Form 1040A (optional return), which may be filed by individuals whose gross income is from certain sources only and is not more than $3,000, does not provide for reporting the amount of net income. Gross income is tabulated both as total income and as net income.

2/ Not available.

* Less than $500.

** Less than 0.005 percent.

Source: Adapted from Statistics of Income for 1942, Part 1, Table 7-A.

Table 5

Annuities reported on taxable and nontaxable individual returns with net income, 1943, by net income classes; also aggregates for returns with no net income

(Net income classes and number of returns in thousands; money figures in millions)

Net income classes 1/		Total number of returns	Total income		Annuities		
			Amount	Percentage distribution	Amount	Percentage of total income	Percentage distribution
Returns with net income:							
Form 1040A 2/	(est.)	20,341.5	$ 31,086.5	29.1%	3/	3/	3/
Form 1040:							
Under $5	(est.)	21,563.4	54,776.3	51.3	$ 88.1	.2%	69.5%
5 " 10		1,099.6	8,033.3	7.5	14.0	.2	11.0
10 " 25		384.9	6,252.7	5.9	12.3	.2	9.7
25 " 50		84.8	3,125.5	2.9	5.3	.2	4.2
50 " 100		24.8	1,813.7	1.7	3.4	.2	2.7
100 " 150		4.4	585.3	.5	.9	.2	.7
150 " 300		2.3	501.3	.5	.6	.1	.5
300 " 500		.4	184.1	.2	.3	.2	.2
500 " 1,000		.3	161.2	.2	.1	.1	.1
1,000 and over		*	94.3	.1	.1	.1	.1
5 and over		1,601.5	20,751.4	19.4	37.0	.2	29.2
Total Form 1040 A and Form 1040 with net income		43,506.6	106,614.2	99.8	125.1	.1	98.7
Returns with no net income, Form 1040		215.5	170.8	.2	1.7	1.0	1.3
Grand total		43,722.0	106,785.1	100.0	126.8	.1	100.0
Total, Form 1040A		20,341.5	31,086.5	29.1	3/	3/	3/
Total, Form 1040		23,380.5	75,698.6	70.9	126.8	.2	100.0

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1/ Data for returns Forms 1040A and 1040 with net income under $20,000 and with no net income estimated from a sample.

2/ Form 1040A (optional return), which may be filed by individuals whose gross income is from certain sources only and is not more than $3,000, does not provide for reporting the amount of net income. Gross income is tabulated both as total income and as net income.

3/ Not available.

* Less than 50 returns.

Source: Individual and Taxable Fiduciary Income Tax Returns for 1943, Extract from the Treasury Bulletin, United States Treasury Department, June 1947, Tables 4 and 6(a).

Table 6

Annuities and pensions reported on individual returns for 1944 by size of adjusted gross income

(Adjusted gross income classes and money figures excepting averages in thousands)

Size of adjusted gross income	Total number of returns	Adjusted gross income	Annuities and pensions: Number of returns	Percentage of total returns	Amount	Amount as a percentage of adjusted gross income	Average annuity and pension per return reporting such income	Average annuity and pension per return for all returns
Taxable returns:								
$0.5 Under $0.75	2,045,206	$1,337,580	12,954	.63%	$5,025	.38%	$ 388	$ 2
0.75 " 1	2,950,919	2,586,239	19,208	.65	9,656	.37	503	3
1 " 1.25	3,477,486	3,921,519	21,645	.62	13,637	.35	630	4
1.25 " 1.5	3,512,445	4,825,893	16,411	.47	10,845	.22	661	3
1.5 " 1.75	3,459,860	5,614,142	17,676	.51	12,058	.21	682	3
1.75 " 2	3,403,802	6,374,683	13,734	.40	10,617	.17	773	3
2 " 2.25	3,130,449	6,643,163	13,333	.43	7,238	.11	543	2
2.25 " 2.5	2,870,005	6,811,467	14,168	.49	8,597	.13	607	3
2.5 " 2.75	2,786,617	7,307,911	11,938	.43	7,717	.11	646	3
2.75 " 3	2,514,455	7,222,747	9,622	.38	7,313	.10	760	3
3 " 3.5	4,133,166	13,378,813	14,018	.34	8,453	.06	603	2
3.5 " 4	2,785,527	10,394,197	13,349	.48	9,487	.09	711	3
4 " 4.5	1,777,741	7,516,504	9,177	.52	7,275	.10	793	4
4.5 " 5	1,039,236	4,915,701	6,278	.60	5,396	.11	860	5
5 " 6	933,071	5,057,083	9,874	1.06	8,204	.16	831	9
6 " 7	417,756	2,693,021	5,803	1.39	6,403	.24	1,103	15
7 " 8	220,512	1,645,762	3,254	1.48	3,346	.20	1,028	15
8 " 9	151,103	1,279,043	2,311	1.53	3,169	.25	1,371	21
9 " 10	111,991	1,060,155	1,686	1.51	1,638	.15	972	15
10 " 11	88,911	931,357	1,447	1.63	1,626	.17	1,124	18
11 " 12	67,593	775,780	1,122	1.66	1,227	.16	1,094	18
12 " 13	57,375	715,970	1,113	1.94	1,231	.17	1,106	21
13 " 14	46,036	620,510	961	2.09	1,061	.17	1,104	23
14 " 15	38,563	558,495	775	2.01	1,356	.24	1,750	35
15 " 20	129,466	2,224,022	2,654	2.05	3,586	.16	1,351	28
20 " 25	67,537	1,504,311	1,684	2.49	1,927	.13	1,144	29
25 " 30	38,435	1,049,789	1,079	2.81	2,057	.20	1,906	54
30 " 40	41,610	1,430,927	1,287	3.09	2,436	.17	1,893	59
40 " 50	20,422	907,988	679	3.32	1,436	.16	2,115	70
50 " 60	11,844	645,763	438	3.70	1,085	.17	2,477	92
60 " 70	7,253	468,959	312	4.30	1,030	.22	3,301	142
70 " 80	4,668	348,712	203	4.35	589	.17	2,901	126
80 " 90	3,063	259,874	155	5.06	364	.14	2,348	119
90 " 100	2,135	202,711	104	4.87	367	.18	3,529	172
100 " 150	4,873	584,702	266	5.46	984	.17	3,699	202
150 " 200	1,565	267,591	97	6.20	593	.22	6,113	379
200 " 250	665	146,936	40	6.02	136	.09	3,400	205
250 " 300	351	95,709	23	6.55	51	.05	2,217	145
300 " 400	318	108,299	22	6.92	101	.09	4,591	318
400 " 500	155	68,726	14	9.03	154	.22	11,000	994
500 " 750	159	95,263	9	5.66	68	.07	7,556	428
750 " 1,000	62	53,754	6	9.68	64	.12	10,667	1,032
1,000 " 1,500	38	46,863	3	7.89	53	.11	17,667	1,395
1,500 " 2,000	12	21,226	-	-	-	-	-	-
2,000 " 3,000	6	14,108	2	33.33	6	.04	3,000	1,000
3,000 " 4,000	2	6,366	-	-	-	-	-	-
4,000 " 5,000	3	13,329	-	-	-	-	-	-
5,000 and over	1	7,719	-	-	-	-	-	-
Total, taxable returns	42,354,468	114,761,385	230,934	.55	169,660	.15	735	4
Nontaxable returns:								
No adjusted gross income	191,905	249,771 1/	1,369	.71	1,060	2/	774	6
Under $0.5	3,260,590	947,548	7,688	.24	2,066	.22	269	1
0.5 " 0.75	851,628	476,487	9,583	1.13	3,208	.67	335	4
0.75 " 1	220,253	193,918	4,002	1.82	1,967	1.01	492	9
1 " 1.25	137,609	149,507	2,528	1.84	1,492	1.00	590	11
1.25 and over	95,042	185,892	2,534	2.67	1,950	1.05	770	21
Total, nontaxable returns	4,757,027	1,703,580 3/	27,704	.58	11,743	.69	424	2
Grand total, all returns	47,111,495	116,464,965 3/	258,638	.55	181,403	.16	701	4
Returns with adjusted gross income under $5,000 4/	44,643,941	90,554,141	221,215	.50	135,057	.15	611	3
Returns with adjusted gross income of $5,000 and over	2,467,554	25,910,825	37,423	1.52	46,346	.18	1,238	19

Treasury Department, Division of Tax Research

1/ Adjusted gross deficit.
2/ Percentage is meaningless as these returns have no adjusted gross income.
3/ Adjusted gross income less deficit.
4/ Includes all nontaxable returns.

Source: Adapted from press releases dated June 25, 1947 and August 21, 1947 (Press Service Nos. S-366 and S-436) for Statistics of Income for 1944, Part I.

Table 7

Annuities and pensions reported on individual returns for 1944, by size of annuity and pension income

Size of annuity and pension income	Number of returns	Percentage distribution
(Thousands of dollars)		
Under 0.1	46,952	18.2%
0.1 under 0.2	32,439	12.5
0.2 under 0.3	22,113	8.5
0.3 under 0.4	23,139	8.9
0.4 under 0.5	13,809	5.3
0.5 under 0.75	36,120	14.0
0.75 under 1	24,519	9.5
1 under 1.25	26,268	10.2
1.25 under 1.5	9,005	3.5
1.5 under 1.75	9,166	3.5
1.75 under 2	3,614	1.4
2 under 2.5	4,909	1.9
2.5 under 3	1,967	.8
3 under 5	3,269	1.3
5 under 10	990	.4
10 under 25	283	.1
25 and over	76	*
Total	258,638	100.0

Treasury Department, Division of Tax Research

* Less than .05 percent.

Source: Bureau of Internal Revenue.

Table 8

Number of annuitants currently being paid and amounts of payments for important annuitant groups

Group of annuitants	As of date	Number of individuals	Total annual payments	Average annual payment per individual
Federal Civil Service employees 1/	June 30, 1945	85,225	$ 82,345,858	$ 966
State and local government employees 2/	Last month of fiscal year 1945	208,000	177,500,000	853
Annuitants, including group plans, reported by life insurance companies 3/	December 31, 1945	560,443	202,921,497	362
Individual annuitants reported by life insurance companies 3/	December 31, 1945	406,866	126,654,159	311
Social Security 4/	February 1947	1,708,800	389,604,000	228
Railroad Retirement 4/	February 1947	197,400	166,944,000	846
Retired inactive Army and Navy personnel 5/	Fiscal year 1947	67,805	141,600,000	2,088
Private industrial pension plans 6/				

Treasury Department, Division of Tax Research

Note: Payments include disability benefits.

Footnotes on next page.

Table 8 (concluded)

Number of annuitants currently being paid and amounts of payments for important annuitant groups

FOOTNOTES

1/ U.S. Civil Service Commission, Retirement Report, fiscal year ended June 30, 1945, p. 22.

2/ Partly estimated data (corrected to June 6, 1946) from Federal Security Agency, Social Security Administration, Social Security Yearbook, 1945, Table 11, page 18. Numbers of beneficiaries as of last month of fiscal year, usually June; amounts of benefit payments for fiscal year. Figures exclude lump-sum survivorship benefits and beneficiaries.

3/ The Spectator, Insurance Year Book, Life Insurance, 1946, pp. 168A-169A.

4/ Federal Security Agency, Social Security Administration, Social Security Bulletin, April 1947, p. 41. Annual payments estimated on the basis of 12 times the payments during the month of February 1947.

5/ Partly estimated data from Hearings before the Subcommittee of the Committee on Appropriations, House of Representatives, 80th Cong., 1st Sess., on First Deficiency Appropriation Bill for 1947, pp. 368, 370, and 372; Budget of the United States Government for fiscal year 1948, p. 651; and information supplied by the War and Navy Departments. Note: figures do not include personnel certified to the Veterans' Administration for retirement benefits.

6/ Not available. An unpublished study of the Bureau of Internal Revenue shows 6,862 industrial pension plans approved by the Bureau as of August 31, 1946. Under these plans there were 3,290,608 employees participating, or 34.1 percent of the 9,663,521 total employees of the companies involved. Of these, there were probably about 2 million employees under self-insured plans not covered by life insurance companies.

Table 9

Civil Service annuitants on the roll by size of annuity

(fiscal 1945)

Size of annuity	Number of annuitants	Percentage distribution 1/
Less than $ 100	208	.2%
100 - 199	1,089	1.3
200 - 299	2,552	3.0
300 - 399	2,967	3.5
400 - 499	3,366	3.9
500 - 599	4,546	5.3
600 - 699	5,743	6.7
700 - 799	5,190	6.1
800 - 899	5,894	6.9
900 - 999	6,217	7.3
1,000 - 1,099	6,193	7.3
1,100 - 1,199	7,281	8.5
1,200	27,510	32.3
1,201 - 1,299	2,364	2.8
1,300 - 1,399	1,169	1.4
1,400 - 1,499	520	.6
1,500 - 1,599	464	.5
1,600 - 1,699	335	.4
1,700 - 1,799	347	.4
1,800 - 1,899	198	.2
1,900 - 1,999	194	.2
2,000 - 2,099	132	.2
2,100 - 2,199	87	.1
2,200 and over	659	.8
Total	85,225	100.0
Average annuity	$966	

Treasury Department, Division of Tax Research

1/ Percentages are rounded and will not add exactly to total.

Source: U. S. Civil Service Commission, Retirement Report, fiscal year 1945, Table 20, p. 33.

APPENDIX B

Report of the Canadian Royal Commission on the Taxation of Annuities and Family Corporations 1/

The Royal Commission on the Taxation of Annuities and Family Corporations was appointed by the Committee of the Privy Council of Canada in November 1944 at the suggestion of the Minister of Finance. 2/ It was instructed to investigate and report upon (a) the treatment under the Canadian Income War Tax Act of annuities, pensions, and various other periodic payments "of such a character that it is not obvious whether they are solely income or solely capital or partly the one and partly the other," and (b) the taxes imposed under Canadian law on income and successions or inheritances arising upon the death of a person owning a substantial interest in a private or closely held corporation which has accumulated an earned surplus. The Commission was also instructed to consider possible changes in the existing burdens and methods of treatment applicable to such payments and successions. 3/

The major findings of the report with respect to the taxation of annuities and pensions are reviewed briefly in the following sections. The recommendations of the Commission with respect to the treatment of pensions and annuities were adopted under legislation enacted in 1945, with further minor modifications enacted in 1946. 4/

A. Evolution of existing law 5/

1. Contractual and Government annuities

Contractual annuities such as those sold by insurance companies or the Dominion Government were not treated as taxable income from 1917 to 1929. In 1929, a judicial decision in the Kennedy case

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1/ Report of the Royal Commission on The Taxation of Annuities and Family Corporations, 1945, Ottawa, King's Printer, 1945, 99 pp.

2/ Members of the Commission were Mr. William C. Ives, retired Chief Justice, Trial Division of the Supreme Court of Alberta, Dr. D.A. MacGibbon, Winnipeg, Manitoba, and Mr. M.W.Mackenzie,Montreal,P.Q.

3/ The Report of the Commission, submitted to the Minister of Finance March 29, 1945, includes two major parts: Part I, Annuities and other Annual or Periodic Payments and Part II, Taxation of Earned Surpluses of Private or Closely Held Corporations; a memorandum of reservations by Dr. MacGibbon; and three appendices.

4/ See CCH Canadian Tax Service,Vol. 1, Pars. 10-449, 10-452, 10-453. 10-464, 10-465,10-595, and 10-624a and b. 10-625. 10-627, 10-628 and related references.

5/ Based on Report, op. cit., pp. 14-20, 25-29, and 32-36.

found an annuity purchased from the Dominion Government to be taxable. In 1930, in order to protect the sale of Government annuities and at the same time not discriminate against insurance companies, an exemption up to $5,000 was accorded Government annuities and "like" contractual annuity payments by a licensed insurance company. In 1932, this exemption was reduced to $1,200 for new contracts. The $5,000 exemption was continued for prior contracts. The Commission was unable to determine with certainty the practice of the Income Tax Division from 1930 to 1940 in treating annuities other than those covered under the above-mentioned exemptions.

In 1940, the exemption of Government and "like" annuities was abolished except as to pre-existing contracts. Life annuities were henceforth taxed in full. However, in line with a liberalized attitude toward annuities under English case law, after 1940 "annuities certain" or "term annuities" were taxed only on the interest element. The method used in separating the interest and capital elements was to divide the present value of the annuity at the date the annuity matured by the number of payments provided in the annuity contract, the quotient being the capital element in each annuity payment. The Royal Commission summarized the then prevailing treatment of contractual annuities as follows: 1/

(1) Government and "like" annuities taken out prior to May 26, 1932, are exempt up to $5,000 annually. The combined exemption for a husband and wife is the same as that for a single individual. The exemption is restricted to the amount of the annuity specified in the annuity contract before June 25, 1940, regardless of any option or contractual right to enlarge the annuity, unless the additional premiums were paid prior to that date.

(2) Subject to the same limitations, Government and "like" annuities taken out between May 26, 1932 and June 25, 1940 are exempt up to $1,200 annually.

(3) In the case of annuities purchased (or insurance policies maturing) after June 25, 1940, annuities certain are taxed only as to the interest element, while life annuities (including those with a guaranteed term) are taxable in their entirety. 2/

(4) Where a term annuity passes on the annuitant's death to the estate or a beneficiary, the present worth is taken for succession duty purposes and the interest element is taxed as income to the estate or beneficiary.

1/ Report, op. cit., pp. 17-18.
2/ Where an individual has two separate contracts, one for an annuity certain and the other for a deferred life annuity thereafter, the result is in effect a life annuity with a guaranteed term. Nevertheless, the annuity certain is taxable only as to the interest element, the deferred life annuity being taxable in full.

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2. Annuities under wills and trusts

From 1919 to 1930, an annuity received under a will or trust was taxable income to the recipient to the extent it was payable out of the income of the will or trust. After the Kennedy decision in 1929, the Finance Department adopted the practice of taxing such annuities in full whether paid out of income or capital.

After the Whitney case decision in 1936 exempting an annuity paid from an estate, the law was amended in 1938 specifically to tax all annuities or other payments under a will or trust whether paid out of income or capital. In order to mitigate hardships under this provision, a further amendment was added in 1943. Under this amendment annuity or other annual payments out of corpus under the provisions of a will or trust effective prior to January 1, 1944 were exempted up to $1,500 a year.

However, in a subsequent court decision in the O'Connor case, installment payments of a legacy were declared exempt, and the present tax status of annual payments under a will or trust is uncertain.

3. Sickness, accident, and disability payments

The Royal Commission noted that while there was no published ruling on this point, it was the Canadian practice to exempt payments under the terms of sickness, accident, or disability contracts. In 1942, workmen's compensation payments provided under provincial or dominion compensation acts were specifically exempted. The Commission felt that such specific provision might raise the question whether other sickness, accident, or disability benefits might by inference be considered taxable income. 1/

4. Pension, superannuation, and other similar payments

In 1919, employee contributions to a pension fund or plan were allowed as deductions, the pension itself to constitute taxable income to the recipient. Lump-sum retirement settlements and survivor benefits were included in taxable income by amendments in 1927 and 1941, respectively. In 1942, in order to avoid undue burdens on lump-sum payments under pension plans, it was provided that only one-third of such payments should be included in taxable income. In 1944, it was provided that lump-sum settlements by an employer to a retiring employee outside of an approved pension plan were to be taxed one-fifth in the year received and one-fifth in each of the succeeding four years. 2/

1/ Report, op. cit., p. 20.

2/ If the employee dies before he has fully reported such a lump-sum settlement, the remaining balance is tax-free. Gifts, not deducted by the employer, and indemnities for loss of office are exempt to the recipient.

Both the one-third rule and the five-year averaging treatment are designed to afford a measure of relief against lumping of income without undue complications. 1/

In 1936, the deduction for contributions by an employee to pension funds was limited to $300 in any one year. This was amended in 1944 to allow an additional $300 deduction for contributions with respect to previous services when the taxpayer was not a contributor and to extend the deduction to retirement contributions to approved plans paid by a trade union member as part of his union dues.

Prior to 1941 employer contributions to pension funds or plans were considered deductible as general expense. Beginning in 1941 various limitations were placed on the employer's right to deduct such contributions.

In 1928, trustees of pension funds were given the right to elect to have the income of the fund exempted from taxation in the trustees' hands. However, it was provided that if such election was exercised, the employee forfeited the right to deduct his contributions, while his retirement pension or lump-sum payment would be exempt in the proportion that the amounts paid by him into the fund after the effective date of the election bore to the total amount paid in by him. 2/ Such an election applies only where there is a separate pension fund, administered by trustees and not where the plan is handled through group annuities purchased from the Government or insurance companies.

In summary, the Royal Commission noted that under then prevailing provisions, there were two types of pension-fund situations. In one type, with a pension fund where the trustees elected to be exempt, the employee's contributions were not deductible but his pension was exempt. Where some of the employee's contributions had been deducted and some had not, the pension to the employee or the survivor was exempt in proportion to the non-deducted contributions. The same applied to lump-sum payments to employees. In the other type of pension plan, with no separate fund, where there was no election, the employee's contributions were deductible within prescribed limits but his pension was wholly taxable to either the employee or the survivor. A lump-sum payment to the employee was one-third taxable. In both types, lump-sum payments to survivors were taxable income to the extent of one-third in the year

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1/ Report, op. cit., pp. 44-45.

2/ In practice, where there was a separate fund, the trustees necessarily elected to be exempt, as it would be virtually impossible for the fund to meet its obligations if it were taxable. Report, op. cit., p. 38.

received. 1/ In both situations, the income earned by the fund, or by the combined employer and employee contributions, there being no separate fund, was not taxed as it accrued, and provisions relating to the deduction of employer contributions were identical. Both types of pensions were treated alike for succession duty purposes. 2/

B. Findings and recommendations 3/

1. Contractual annuities

After discussing different economic concepts of income, the report concluded that (a) the Canadian income has not adopted for fiscal purposes the "income produced" concept and (b) it is inconsistent with this concept and unfair to tax annuities in their entirety. From the broad standpoint of social policy, the report indicated that it is undesirable to tax the return-of-capital element in an annuity, thus penalizing orderly arrangements for the necessary consumption of capital. It further indicated that there was no basis for "prejudice" against life annuities on the grounds that they turned capital into current consumption in view of the current emphasis on maintaining consumer expenditures and fears expressed about over-saving. 4/ In addition, the report noted that overtaxation of life annuities could be largely avoided under then prevailing Canadian law by the expedient of purchasing two separate contracts, one for a term certain covering the individual's life expectancy and the other for a deferred life annuity thereafter.

The following technique of taxing the income element in annuity payments was recommended: 5/

(a) Subtract from the sum total of expected annual payments the purchase price or discounted value 6/ of the annuity. The result

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1/ It should be noted that the five-year averaging provision previously described applied only to non-contractual lump-sum payments, i.e., those made outside a pension plan.

2/ Report, op. cit., p. 35.

3/ Based on Report, op. cit., pp. 20-25, 29-32, and 36-47.

4/ Report, op. cit., p. 25.

5/ This method was suggested to the Commission by Mr. A. D. Watson, Chief Actuary of the Dominion Insurance Department.

6/ Under the recommendation and as adopted under 1945-46 legislation, the discounted value at the time payments began as distinct from the purchase price would apply as the cost basis in the case of the installment purchase of a deferred annuity. This treatment exempts interest accrued prior to the effective date of the annuity. Safeguards have been adopted, however, to prevent tax avoidance where the taxpayer deposits a large sum with an insurance company in purchasing a long-deferred annuity. In such cases the Minister of National Revenue has the discretionary power to add to the income portion the interest earnings on the purchase price accrued prior to the effective date of annuity payments. See Canadian Tax Service, Vol. 1, CCH, Par. 10-449(b).

gives the total income to be taxed during the period of the annuity.

(b) Divide this amount by the number of years the payments are expected to run. 1/ The quotient is the annual taxable amount.

Under this method life-expectancy tables would be used in determining the taxable portion of annuity payments. The report suggested that annuity contracts bear on their face a statement showing the taxable portion or that vendors of contracts supply such information for annuitants. It stated that it would be possible to adapt this method to different types of contracts, extending it to the entire annuities field. The advantages cited for the proposed method are its "simplicity and certainty." 2/

2. Annual or periodic payments under a will or trust

With reference to annual or periodic payments received under the provisions of a will or trust, the report declared the existing tax treatment of such payments to be indefensible. It referred to the triple taxation of capital accumulated and paid out of an estate in annual payments: twice under the income tax and once under the succession duty.

It noted that, if the testator placed safeguards around the distribution of money from his estate, such payments were subject to income tax whether out of corpus or income, whereas if the beneficiaries were allowed to withdraw capital sums at any time in any amount, no income tax was imposed on such capital withdrawals. The result, the report indicated, was to encourage lump-sum settlements. The report also stated that the then prevailing provisions created uncertainty as to what periodic payments would be deemed "annual payments" and therefore fully taxable.

It recommended that the "alien principle of taxing capital" 3/ be abandoned and that the treatment of annual payments under wills or trusts adhere to the basic principle embodied in Canadian income tax laws of taxing income from the use of capital but exempting capital itself. Under this recommendation, payments under the provisions of a will or trust would be taxable only to the extent they were made from the income of the estate or trust.

3. Pension funds

The report found considerable inequality of treatment as between pension-fund situations which are identical in substance. After considerable analysis, it recommended that all pension plans be put on the

1/ This period would be the individual's life expectancy in the case of a life annuity.

2/ Report, op. cit., pp. 29-30.

3/ Report, op. cit., p. 32.

APPENDIX B

same footing by allowing the current deduction of employee contributions, the pension payments to be taxable income in the hands of the recipient. 1/ It also recommended that the earnings of all approved pension funds be exempt in the hands of the trustees.

A further recommendation was that the then prevailing $300 limit on the deduction of employee contributions be removed. It was felt that the situation would be controlled adequately by the requirement of the approval of the plan by the Finance Minister. It was, however, urged that if some upper limit on such deduction be deemed necessary the existing limit should be raised and reviewed from time to time in the light of current interest levels and other economic conditions. 2/ In this connection the Commission expressed its view that specific provisions of the tax law, even if somewhat arbitrary, are nevertheless preferable to reliance on administrative discretion.

The report also indicated the existing maximum limit on the deduction of employer contributions should be removed. However, it suggested that continuing supervision should be added to the requirement of initial approval of the pension plan.

The report noted that it would make for greater theoretical equity to tax currently the accruing earnings on savings invested in pension funds, but such an attempt would make the declaration of taxable income unduly complicated.

4. Survivor benefits and lump-sum settlements

The Commission recommended that continuing pensions to survivors be treated as taxable income to the survivor in the same way as if paid to the employee if he had lived. It was further suggested that the discounted value of such pensions should not be treated as an asset of the deceased at the time of his death for succession duty purposes. This treatment was regarded as consistent with the position of the Commission that continuing pensions to survivors are a deferred reward for services, notwithstanding that the services are rendered by one person and the pension is received by another.

The report recommended the continuance of (a) the spreading of non-contractual lump-sum settlements over 5 years for income tax purposes (and its extension to payments as compensation for loss of office) and (b) the present rule of taxing one-third of lump-sum withdrawals of pension-plan contributions which have previously been deducted by the employee (with the addition of the proviso that where an employee resigns

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1/ The report indicated that whatever arrangement was made with respect to individuals who had not deducted their contributions in the past should err in favor of the taxpayer.

2/ As adopted under the 1945 legislation, a $900 annual limit was imposed on the deduction. A similar $900 annual limit was applied to the deduction of the employer's contributions with respect to an individual employee. See CCH Canadian Tax Service, Vol. L, Par. 10-624a and b.

to take employment elsewhere the retirement payment be exempt to the extent it is used to transfer contributions from one fund to another). It also recommended that lump-sum payments to survivors be treated the same as if paid to the employee. These recommendations were adopted under the 1945 legislation. In 1946, however, both the one-third inclusion rule and the five-year averaging method were superseded by new provisions applicable to lump-sum payments under a pension plan or upon retirement made after June 27, 1946. Under the new provisions, the taxpayer has the option of treating such lump-sum payments either as income in their entirety in the year received or as special items of income taxable at the average rate applicable to his previous year's income. 1/

5. Persons outside pension plans

The Commission was friendly to, but rejected numerous suggestions by, witnesses that the postponement of tax on savings for retirement be extended to the self-employed or other persons without access to a pension plan. It was indicated that such extension would be inequitable unless it covered life insurance and various other forms of savings. Furthermore, extension of the principle of exempting current savings would enlarge the problem of taxing lump-sum withdrawals and involve serious administrative difficulties.

6. Summary of recommendations 2/

The following is a summary of the Commission's recommendations with respect to pensions and annuities:

(1) The return-of-capital element in contractual annuities should be exempted. The method of taxing the income portion used in connection with term annuities (dividing the aggregate income by the term of years the annuity is to run) should be extended to life annuities using life expectancy as the term.

(2) Annual or periodic payments under a will or trust should be taxable only to the extent paid out of the income of the estate or trust.

(3) The earnings of all approved pension funds should be exempt from tax in the hands of the trustees. Employees' contributions to such pension funds should be currently deductible and the pensions fully taxable when received. Where employees in the past have not been entitled to deduct their contributions, only a proportionate part of the pension should be taxable. Existing limits on the deduction of employer and employee contributions to pension funds should be removed. Pension funds should be subject to continuing official supervision.

1/ See CCH Canadian Tax Service, Vol. 1, Pars. 10-453, 10-470h, 10-920, and 10-921.

2/ Report, op. cit., p. 47.

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(4) Survivors' pensions should be taxable as income to the same extent as if paid to the employee. The value of a survivor's pension should be exempt from succession duty.

(5) Existing methods of including in taxable income one-third of taxable lump-sum settlements from a pension fund or plan should be continued. The practice of spreading lump-sum retirement payments (other than from a pension fund or plan) over 5 years for tax purposes should be continued and extended to payments for loss of office. 1/

(6) Life insurance or deferred annuity premiums should continue to be non-deductible for income tax purposes.

1/ As previously noted, this recommendation was adopted in 1945 but superseded in 1946.

APPENDIX C

Formulas for Determining Benefits under Present Social Security and Railroad Retirement Provisions 1/

I. Social security old-age and survivors' benefits

A. Primary benefit - the sum of the following two amounts:

1. The sum of 40 percent of the first $50 and 10 percent of the next $200 of average monthly wage, 1/ plus

2. One percent of the amount in (1) multiplied by the number of years in which worker received credit for annual wages of $200 or more.

If the primary benefit as computed is less than $10, it is increased to $10.

B. Old-age benefits - monthly benefits to family of retired worker as follows:

1. Retired worker - monthly payments equal primary benefit if he retires at age 65 or later.

2. Wife (over 65) of retired worker - one-half of primary benefit.

3. Child (under 18) of retired worker - one-half of primary benefit.

C. Survivorship benefits - monthly benefits to family of deceased worker as follows:

1. Widow (over 65 or with children under 18) - three-fourths of primary benefit.

2. Child (under 18) - one-half of primary benefit.

3. Dependent parent (over 65) - one-half of primary benefit. 2/

D. Maximum benefit

Maximum total old-age or survivors' benefit for family of a worker is the lowest of the following three amounts:

1/ To receive payments under the programs, beneficiaries must meet other qualifications, such as the provision suspending benefit payments when the beneficiary's earnings in covered employment reach $15 a month, in addition to those mentioned below.

2/ Payable only if worker left no widow or children under 18.

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1. Twice the primary benefit.

2. 80 percent of average monthly wage.

3. $85.

Maximum is applicable only when total family benefits based on the worker's wages exceed $20. Moreover, if maximum is applied, it must not reduce total benefit below $20.

E. Minimum benefit

Minimum total family benefit is $10; if formula gives smaller amount, the total benefit is raised to $10.

F. Summary of smallest and largest benefits currently payable

	Smallest benefit		Largest benefit a/	
	Monthly	Annual	Monthly	Annual
Old-age benefits:				
Retired worker (primary benefit)	$10.00	$120	$44	$528
Worker and wife (or worker and one child) - 1-1/2 times primary benefit	15.00	180	66	792
Survivorship benefits:				
Widow - 3/4 of primary benefit	10.00	120	33	396
Widow and one child - 1-1/4 times primary benefit	12.50	150	55	660
Widow and two children - 1-3/4 times primary benefit	17.50	210	77	924
Widow and three or more children b/ (or retired worker and two children) - 2 times primary benefit	20.00	240	85	1,020

a/ Based on maximum monthly compensation of $250 and 10 years of coverage from 1937 to 1946, inclusive.

b/ The benefits computed under the general rule (2-1/4 times the primary benefit) are reduced to indicated size by the limitations regarding maximum benefits.

II. Railroad retirement benefits

A. Retirement annuities (non-disability)

1. General formula for monthly rate - take
   2 percent of the first $50 of average monthly compensation, plus
   1-1/2 percent of the next $100, plus
   1 percent of the next $150

   and multiply the sum of these three amounts by the number of years of service.

2. The amount so computed may be subject to reduction if worker retires before age 65. Workers with 30 years of service may retire after age 60 subject to reduction of benefits by 1/180th for each month below age 65 in the case of men, with no such reduction in the case of women.

3. Maximum annuity - at present, the maximum number of years of service that can be counted is 30, 1/ so that maximum annuity is $4 times 30, or $120 monthly, or $1,440 annually.

4. Minimum annuity - the lowest of the following three amounts:

   a. $50
   b. $3 multiplied by the number of years of service.
   c. Average monthly compensation.

   Such lowest amount applies before any reduction for early retirement as described above.

   Minimum is applicable only if worker has at least 5 years of creditable service and has a current connection with the railroad industry at time of retirement. If these conditions are not met, general formula in (1) above applies and annuity may be exceedingly small, depending on period of service. If the computed monthly payment is less than $2.50, the annuity may be paid quarterly or in a single lump sum equal to its commuted value.

1/ If service before January 1, 1937 is counted, "years of service" are limited to 30. Employees who have more than 30 years' service after December 31, 1936 may credit all their service after that date. This means that no one can count more than 30 years of service until after December 31, 1966.

APPENDIX C

B. Survivorship benefits

1. Basic amount - the sum of the two following amounts:

   a. The sum of 40 percent of the first $75 and 10 percent of the next $175 of average monthly compensation.
   b. 1 percent of the amount in (a) multiplied by the number of years after 1936 in which worker received credit for $200 or more of annual compensation.

   If the basic amount as computed is less than $10, it is increased to $10.

2. Monthly benefits to family of deceased worker:

   a. Widow (over 65 or with children under 18) - 3/4 of basic amount.
   b. Child (under 18) - 1/2 of basic amount.
   c. Dependent parent (over 65) - 1/2 of basic amount.1/

3. Maximum total benefit for family of a deceased worker is the lowest of the following three amounts:

   a. Twice the basic amount.
   b. 80 percent of average monthly wage.
   c. $120.

   Maximum is applicable only when total family benefit exceeds $20. Moreover, if maximum is applied, it must not reduce total benefit below $20.

4. Minimum total family benefit is $10; if formula gives smaller amount, the total benefit is raised to $10.

1/ Payable only if worker left no widow or children under 18.

APPENDIX C

C. Summary of smallest and largest benefits currently payable

	Smallest benefit: Monthly	Smallest benefit: Annual	Largest benefit: Monthly	Largest benefit: Annual
Retired worker's annuity a/	b/	b/	$120	$1,440
Survivorship benefits: c/				
Basic amount	$10	$120	52.25	627
Widow - 3/4 of basic amount	10 d/	120	39.19	470
Widow and one child - $1\frac{1}{4}$ times basic amount	12.50	150	65.31	784
Widow and two children - 1-3/4 times basic amount	17.50	210	91.44	1,097
Widow and three or more children e/ - 2 times basic amount	20	240	104.50	1,254

Treasury Department, Division of Tax Research

a/ Largest benefit is based on maximum average monthly compensation of $300 and 30 years of service.

b/ Retired worker's benefit may be indefinitely small, depending on the duration of his credited service.

c/ Largest benefits are based on maximum average monthly compensation of $250 and 10 years of coverage from 1937 to 1946, inclusive.

d/ Minimum benefit of $10 monthly applies.

e/ The benefits computed under the general rule ($2\frac{1}{4}$ times the basic amount) are reduced to indicated size by the limitations regarding maximum benefits.

APPENDIX D

ANNUITIES AND PENSIONS 1/

A. Annuity Income

Annuities have been a popular form of investment in recent years and, because of the nature of annuity income, special treatment is required in the preparation of a Federal income tax return.

There are several forms of annuities, of which the most common are the following types sold by insurance companies:

(1) Single-premium immediate life annuity.-A person (hereafter referred to as the "annuitant") may purchase, for a flat sum, i.e., a single-premium payment, an annuity policy which provides him with a monthly or annual income for life, beginning at once. In regard to the payments to be made by the insurance company after his death, there are two types of policies:

(a) Nonrefund basis.-Upon death of the annuitant, the policy terminates and no further payment is made to any person-that is, the portion, if any, of the premium (capital) not recovered by the annuitant through the receipt of annuities during his lifetime is forfeited.

(b) Refund basis.-In consideration for the payment of a higher premium than that paid for a nonrefund policy, the refund policy provides in part for a full return of capital, either to the annuitant during his lifetime or in part to the annuitant during life and the balance to his beneficiary after his death.

(2) Single-premium deferred life annuity.-The annuitant pays the specified premium but defers receiving the annuity income until after a stated future date. This policy also may be procured either on the nonrefund basis or on the refund basis.

(3) Annual premium deferred life annuity.-The annuitant contracts to pay an annual premium beginning at once, for a life annuity which will begin at a specified age, as 65 years, on either the nonrefund basis or the refund basis. In some policies of this type, the annuitant may elect to stop payment of annual premiums and to have payments of annuity begin at any desired time.

(4) Joint and survivorship annuity, nonrefund type.-For a stated cost, as $10,000, the contract provides that a specified annuity will be paid to the annuitant for life, then to a designated second person for life, with no further payment to any person.

1/ Article No. 23 from Your Federal Income Tax (1946 Edition), Treasury Department, Bureau of Internal Revenue, pp. 61-64.

(5) Joint and survivorship annuity with term certain.-This is a refund type of annuity policy which includes a guaranty of the return of part, if not all, of the premium (capital) either to the annuitant during his life, or in part to the annuitant during life and the balance to his beneficiary after his death.

(6) Annuity with endowment insurance, also known as "retirement income policy."-In consideration for the payment of annual premiums for a specified number of years, as 30 years, the policy provides for the payment of an annuity for life beginning at a stated future time, as 65 years of age, and may guarantee the refund of the entire premium (capital) through a cash surrender value, or through insurance, or "death benefit," payable to a beneficiary upon death of the annuitant. Such a policy may provide, for instance, $1,000 insurance for each $10 monthly income at age 65, with income payable for a fixed period, such as a term of years, or for an indefinite period such as for life, or for life and a guaranteed fixed period such as a guaranteed minimum period of 10 years; however, the policy may provide for a smaller payment and a longer guaranteed term.

While the courts have not agreed upon a standard definition of the term "annuity," the Bureau of Internal Revenue has described it as "a stated sum payable periodically at stated times during life, or a specified number of years, under an obligation to make the payments in consideration of a gross sum paid for such obligation, which gross sum is exhausted in the making of the periodic payments."

In such annuity contracts as those described above a portion of each annuity payment represents a partial return of the principal to the annuitant, and the balance of each payment represents interest on the sum or sums paid for the policy or contract. Since the cost of the annuity may be recovered tax-free as a return of capital, only that portion of the payments which represents interest on the cost of the policy or contract is taxable income, and for purposes of uniformity the law provides in effect that this portion shall be considered as equal to 3 percent of the total cost of the policy until there has been excluded from gross income, usually over a period of years, an amount equal to the principal sum paid for the policy. Thereafter, the entire amount of the annuity is taxable income.

Annuity income, accordingly, must be reported in the Federal income tax return. The right to the annuity income may have been purchased by payments made from your earnings or savings, or by the investment of tax-exempt proceeds which you had received as the beneficiary of a life insurance policy issued to another; it may have been a gift to you from someone else; or you may receive it as a beneficiary and survivor of a deceased annuitant--in each case your income from the annuity is subject to the income tax.

If the annuity derives from a straight single-premium annuity contract, then the cost to be shown would be the amount of the single premium paid for the policy. If the annuity is received by the policyholder of an endowment insurance contract, payable in installments to the policyholder, then the cost is the sum of the premiums paid for the policy. If you received the annuity as a gift from another, your cost is the same as your donor's cost.

In addition to the cost of the policy, as stated above, there must be considered the amount of the annuity income received during the year.

Turn to Schedule A on page 2 of your income tax return for 1946 (on the back of page 1) and enter on line 4 of this schedule the total of the annuity payments received during 1946. To ascertain how much, if any, of this total represents a nontaxable return of capital, and how much is taxable, enter the total cost of the annuity on line 1 of the schedule, subtract on line 2 the total of the amounts received tax-free in 1945 and prior years (that is, subtract the total of the amounts received in all prior years less 3 percent of line 1 for each year during which the annuity has been received since 1933), and enter the remaining cost or capital, if any, on line 3.

Compare this figure with the 1946 annuity on line 4 and if the latter is the larger, enter the difference on line 5. This will show that the entire cost has now been recovered tax-free and that all annuity payments received from that point on are taxable. If, however, the 1946 annuity does not exceed the remaining cost, write the excess on line 5 as "None."

The taxable income to be entered on line 6 of the schedule is then the figure on line 5, or 3 percent of line 1, whichever is greater, except that if the total annuity received in 1946 is less than 3 percent of line 1, the taxable income on line 6 should not be more than the income received. When the first annuity payments under the contract are received, they usually do not cover an entire taxable year, and the portion representing taxable income may be ascertained by prorating the 3-percent amount to the number of months for which the payments are made. To do this, divide the 3-percent figure by 12 and multiply by the number of months. Assume, for instance, that the cost of your annuity is $8,000 and that during 1946, the first year in which any annuity payments are made, you receive two monthly payments of $100 each beginning November 1. Then 3 percent of $8,000 is $240 for a full year; $240 divided by 12 equals $20; $20 multiplied by 2, the number of months for which the payments are made, equals $40; and in determining the taxable income to be entered on line 6 of Schedule A, this is the amount for the 2-month period to be compared with the figure on line 5 of Schedule A to see which is the greater.

If you have recovered your cost tax-free in prior years, or if the entire cost of your annuity was paid by a former employer, you may omit lines 1 to 5, inclusive, and enter directly on line 6 the total amount received in 1946, and thereafter, the whole annuity income each year must be entered as taxable income.

Pensions or retirement pay received from employees' trusts should be treated in the same way as annuities. If the trust is one which meets the statutory tests for exemption from income tax, the amounts, if any, contributed by you as an employee constitute your basic cost of the annuity; if you made no payments to the trust, your cost is zero. If, however, the trust is not exempt from tax, contributions to the trust by the employer are treated as additional compensation to you as the employee, and are taxable to you when credited to the trust, if your rights to a future annuity would not be forfeited by your resignation or discharge occurring before the retirement date. Amounts thus taxed to you as the employee may be treated as part of your basic cost of the annuity.

B. Annuities, Pensions, and Retirement Pay Distinguished

The terms "annuity," "pension," and "retirement pay" are often confused with each other. Sometimes these terms are used to describe a plan in which an individual invests some of his own money—either with an insurance company or with his employer—in order to assure himself that he will receive a steady income when he reaches a certain age. At other times, the same terms are used to describe payments which are made by an employer entirely out of his own funds to reward a faithful employee.

For income tax purposes, all of these plans are, in effect, treated alike so that the recipient of an annuity, pension, or retirement pay is allowed to recover his own investment, if any, tax-free but is required to pay tax on the remainder of the benefits that he receives, as explained in the first part of this article. Therefore, in those cases where the employer pays the entire cost of a pension, the retired employee has no cost to recover and his entire pension is taxable as if it were a payment of additional wages and salary.

An exception to this rule occurs where the law specifically exempts certain payments from income tax, such as the pensions which the Government pays to war veterans and their families, and the old-age benefits which are paid by the Government as administrative expenditures in the interest of the general welfare of the public under the Federal social security laws.

As explained previously, an annuity, generally speaking, is a form of investment wherein you purchase the right to receive a monthly or annual income for life. A portion of each annuity payment received represents a partial nontaxable return of the principal or purchase price, and the balance of each payment represents taxable income.

The original idea of a pension appears to have been a gift or gratuity made to a former employee on account of past services which had been fully paid for when rendered, but it developed into a deferred compensation for services as an inducement to secure continued service from employees. Accordingly, a pension or a retirement allowance paid entirely by the employer represents, for Federal income tax purposes, amounts paid solely because of services. They are regarded as additional compensation for services and the entire amount of each payment is subject to income tax unless expressly exempted from tax by law. These amounts may be entered in your income tax return for 1946 as "wages" (line 1 or 2 of a Withholding Statement or item 2, page 1, of Form 1040). However, if you file your return on Form 1040 and prefer to enter your pension in the annuity schedule (Schedule A, page 2, Form 1040), you may do so.

For instance, an employee works for many years for a civilian manufacturer and then retires because of disability or advanced age. His employer continues to pay him a salary or "pension" because of his past services, treating the payments as current expenses for compensation. This pension is compensation subject to income tax and it is subject to the withholding of income tax by the employer.

After the employee's death, the employer may continue the payment of the pension to the employee's widow. Two types of cases occur. In one, there was no previous agreement that any payment would be made to the widow, but the employer made such payments voluntarily for a limited period, usually not more than 2 years, after the employee's death, in recognition of the services which he had rendered. In such circumstances, the payments to the widow are gifts and are not subject to income tax in her hands, although they may be deductible by the employer as business expenses. In the other type of case, there was a contract, a corporate bylaw, or other understanding between employee and employer that after the former's death the payments of salary or pension should be made to the widow, or other beneficiary. Since a legal obligation was created under which the widow could recover from the employer any unpaid amount due, the pension received by her is treated as income taxable to her. Since she is not an employee but receives the pension as a beneficiary of the deceased employee, it is not subject to withholding.

Officers in the armed forces receive what is called "retired pay" or "retirement pay" after they retire from active service. They differ from retired civilians in that they are subject to recall to active duty, and their retirement pay has been held to represent compensation not only for services previously rendered but also for holding themselves ready to respond to a further call to duty. Prior to 1942 all of such retirement payments were taxable as compensation regardless of whether retirement was due to age, number of years of service, or disability. Now, however, if they retire on account of injuries or sickness resulting from active service in the armed forces, the "disability retirement pay" is exempt, for 1942 and later years, by express provision of law. However, payments made for retirement on account of age or service are still taxable as compensation and are subject to the withholding of income tax.

Government "pensions" and "compensation" paid to war veterans who are no longer in active service are usually paid on account of disability. As used here and in existing pension laws as amended in 1946, the term "pension" refers to non-service-connected money benefits, and the term "compensation" means money benefits (other than retirement pay) received on account of the service-connected death or disability of a veteran resulting from service in any war. All payments of "pensions" and "compensation" to veterans were formerly treated as taxable compensation, but since 1935 they have in general been exempt from tax by express provision of law.

Between the ordinary commercial annuity, on the one hand, and the compensatory pension or retirement payment, on the other hand, there is a third type of payment met with in the Federal Civil Service Retirement System, teachers' retirement systems in many States, and police and fire departments in numerous cities. Under the provisions of a statute or of a contract, as the case may be, the employer withholds from the employee's pay each pay day a specified percentage of his pay, and transfers the withheld amounts to a specified fund, usually called a "retirement fund," to which additional amounts are added by the employer. When the employee retires, on account of age, number of years service, disability, or other agreed reason, the employer pays him thereafter a monthly retirement allowance which is derived in part from the employee's percentage contributions to the fund and in part from the employer's contributions to the fund.

For Federal income tax purposes this type of retirement pay is treated as an "annuity" and not as a "pension." The cost or purchase price of the retirement annuity is the total amount paid into the retirement fund out of the employee's salary. The treatment of his salary and retirement pay in this type of annuity are explained in further detail in article No. 17 of this series and in the first part of this article.

The distinguishing characteristic that marks the "pension" as different from the "annuity" for income tax purposes is, therefore, that in general the pension is paid entirely out of the employer's funds on account of services, whereas the annuity is paid, in part at least, out of a fund to which the employee has contributed. His contributions to the fund are regarded as an investment of his earnings, and the retirement annuity is the fruit of his investment, thus placing this type of income in the same general class of investment income as interest.

TREASURY DEPARTMENT

Washington

FOR IMMEDIATE RELEASE
Friday, November 28, 1947

Press Service
No. S-546

The Secretary of the Treasury today announced the subscription and allotment figures with respect to the current offering of 1-1/8 percent Treasury Notes of Series A-1949, to be dated December 1, 1947, open to holders of Treasury Certificates of Indebtedness of Series L-1947, maturing December 1, 1947, and 2 percent Treasury Bonds of 1947, maturing December 15, 1947.

Subscriptions and allotments were divided among the several Federal Reserve Districts and the Treasury as follows:

Federal Reserve District	Certificates Exchanged	Bonds Exchanged	Total Exchanged
Boston	$ 74,268,000	$ 13,919,000	$ 88,187,000
New York	1,166,903,000	362,640,000	1,529,543,000
Philadelphia	78,430,000	12,594,000	91,024,000
Cleveland	172,780,000	47,011,000	219,791,000
Richmond	57,756,000	3,905,000	61,661,000
Atlanta	73,620,000	4,125,000	77,745,000
Chicago	595,403,000	74,308,000	669,711,000
St. Louis	107,125,000	6,507,000	113,632,000
Minneapolis	96,720,000	16,083,000	112,803,000
Kansas City	128,691,000	30,651,000	159,342,000
Dallas	88,713,000	4,282,000	92,995,000
San Francisco	258,827,000	51,037,000	309,864,000
Treasury	7,137,000	17,000	7,154,000
TOTAL	$2,906,373,000	$627,079,000	$3,533,452,000

By arrangements made between the Treasury and the Federal Reserve System, the System's holdings of maturing certificates amounting to $138,800,000 will be presented for cash redemption on December 1.

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TREASURY DEPARTMENT

Washington

FOR RELEASE, MORNING NEWSPAPERS
Tuesday, December 2, 1947.

Press Service
No. S-547

The Secretary of the Treasury announced last evening that the tenders for $1,200,000,000, or thereabouts, of 91-day Treasury bills to be dated December 4, 1947, and to mature March 4, 1948, which were offered November 28, 1947, were opened at the Federal Reserve Banks on December 1.

The details of this issue are as follows:

Total applied for - $1,597,300,000
Total accepted - 1,201,105,000 (includes $35,374,000 entered on a non-competitive basis and accepted in full at the average price shown below)

Average price - 99.761 Equiv. rate of discount approx. 0.944% per annum

Range of accepted competitive bids:

High - 99.770 Equiv. rate of discount approx. 0.910% per annum
Low - 99.760 " " " " " 0.949% " "

(35 percent of the amount bid for at the low price was accepted)

Federal Reserve District	Total Applied for	Total Accepted
Boston	$ 3,710,000	$ 3,710,000
New York	1,485,271,000	1,115,181,000
Philadelphia	6,522,000	4,132,000
Cleveland	10,770,000	10,770,000
Richmond	3,950,000	3,950,000
Atlanta	630,000	630,000
Chicago	43,609,000	20,359,000
St. Louis	3,580,000	3,580,000
Minneapolis	5,100,000	4,970,000
Kansas City	15,920,000	15,920,000
Dallas	5,625,000	5,615,000
San Francisco	12,613,000	12,288,000
TOTAL	$1,597,300,000	$1,201,105,000

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TREASURY DEPARTMENT

Washington

FOR IMMEDIATE RELEASE,
Tuesday, December 2, 1947.

Press Service
No. S-548

Secretary Snyder announced today the appointment of James J. Saxon as an Assistant to the Secretary.

Mr. Saxon has been employed by the Treasury Department for the past 11 years, serving as a Securities Analyst in the Office of the Comptroller of the Currency from 1937 to 1940 and with the Foreign Funds Control and Office of International Finance from 1940 to date. In 1941, he was designated Treasury Attache to Francis B. Sayre, U. S. High Commissioner to the Philippine Islands. He accompanied the Commissioner to Corregidor after invasion of the Islands, where he was engaged in activities to prevent gold, silver and other liquid assets from falling into the hands of the enemy. When the President directed Mr. Sayre to evacuate Corregidor, Mr. Saxon also was ordered to leave. He returned to the United States via Australia.

During the War, Mr. Saxon held many posts as a Treasury representative in Hawaii, Puerto Rico, Africa, Italy, France, England, and Sweden. Prior to his present appointment as Assistant to the Secretary, he was assigned to the Office of International Finance as Special Assistant to the Director.

Mr. Saxon was born on April 13, 1914, in Toledo, Ohio, and is the son of Mr. and Mrs. Samuel J. Saxon of that city. He received a Ph.B. degree from St. Johns College in Toledo in 1936 and later attended Catholic University and Georgetown University School of Law. Mr. Saxon is married and resides at 6317 Woodside Place, Chevy Chase, Maryland. He has a small son, James Joseph, Jr.

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TREASURY DEPARTMENT

Washington

(The following address by Secretary Snyder before the Houston Chamber of Commerce, at the Rice Hotel, Houston, Texas, is scheduled for delivery at 9:00 P.M., C.S.T., on December 6, 1947, and is for release at that time.)

We, in the United States, are experiencing today the greatest measure of prosperity in our history.

But, at the same time, we are living in a world of economic instability. Because of this, we are deeply concerned today as to how we can best preserve and strengthen that driving force of our own economy which has brought us to our present levels of high productive activity.

We cannot underestimate the involved economic and social problems of this era, or the great impact their improper solution would have upon our whole society. But, on the other hand, there is no real doubt of our capacities to deal resolutely with these problems when we fairly appraise the past accomplishments of the American people, when we take into account their present abilities and achievements, and when we consider future prospects.

For we have only begun to realize the immensity of our national resources. We have only begun to measure the great reserves of national assets which hold such tremendous promise for the future development of this country.

The fundamental economic potential of the United States lies in the great resources of this Nation and, so strikingly, in the individual and community efforts of its people.

Houston, in itself, is an inspiring example of that community of effort which has collectively fostered our national growth and power. The development of your city has reflected the general trends of all progressive American communities, although in some respects it has outdistanced them.

Since the days of Sam Houston, your citizens have been determined to gain municipal greatness. And, under the aggressive leadership of your illustrious sons, you have not only reached this goal, but in so doing, have made an important contribution to our national economic life.

Such men as Jesse Jones, Will Clayton, Joe Evans, and F. M. Law, with whom I have had the pleasure of personal association, are among the many Houstonians who ably carry on your tradition of community and national service. Their efforts and the prevailing common interest of your citizenry assure continued great strides in Houston's growth.

Situated as you are in the economic center of the rich Gulf Coast Area, with its vast resources of oil, gas, chemicals, and agriculture, the importance of Houston and its surrounding area to our national growth is widely recognized.

Tremendous fields of natural gas which have been discovered along the Gulf Coast are the basis for a rapidly growing natural gas industry.

Houston is right in the center of the development of the industrial chemical industry. This industry has expanded nearly fourfold since 1939 -- one of the truly remarkable achievements in recent progress.

Numerous other factors have played important roles in the progress of your city. Among these has been the remarkable development of the port of Houston.

Houston is the world's leading spot cotton market as well as the largest cotton shipping port. It is an important center of the rice industry, and for the manufacture of oil field tools and supplies.

Present business activity in this area is apparently above the national average, as indicated by recent bank debits and department store sales.

All of these factors which mark your development are symbolic of the economic progress of the country as a whole.

For, in the slightly more than two years since the end of the war, we have accomplished a most remarkable national production record. And, even with this record breaking production, the domestic and world demand for our goods, has, in some lines, far exceeded our capacity to supply. The pent-up need for American goods, however, is in itself a strong support to our continued prosperity.

As members of a rapidly expanding business community, you gentlemen of Houston are fully aware of the close connection between economic and trade development. Texans, living in a region where growth and progress are a tradition, need not be reminded of the remarkable increase of income in their state. Income payments to individuals in Texas rose from approximately \$2,500,000,000 in 1940 to \$6,750,000,000 in 1946. The share of Texas in the total national income advanced from 3½ per cent to 4 per cent in those years.

At the same time, there has been a parallel increase of trade between Texas and other states. As measured by railway freight, for example, Texas received from other states in 1940 about 25 million tons, while in 1946 the tonnage reached almost 48 million tons. The railway freight movement to your state nearly doubled in this six-year period.

Concurrently, shipments from Texas to the rest of the country increased in the same proportion. These figures indicate that this great increase of production, incomes and employment in Texas, which stimulated trade with other states, has been a boon to producers not only here but also in other sections of the United States.

During this period of the growth of Texas, symbolizing our national expansion, it is interesting to note what has been happening in the international field. Fifty years ago, when Canada was largely an agricultural, mining and lumbering country, the exports from the United States to Canada were relatively small. But as Canada developed industrially, it became one of our foremost foreign markets. In 1946 the value of shipments to Canada was about 15 per cent of the total United States exports. In this half century, Canada was producing more and more of the manufactured articles in which the United States itself specializes. Yet the actual value of trade between the two countries increased several-fold, and Canada's share in U. S. exports more than doubled.

The same general trend is visible in our trade with Latin America, although economic development has not been as rapid in that area.

In Mexico, for example, there has been much new activity and a great increase in the output of the textile industry, in iron and steel, in automobile tire manufacturing and in many other types of production. Hand in hand with this expansion of domestic output has come Mexico's demand for United States merchandise, a demand which has risen far beyond any previous levels. As a result, our exports to Mexico in 1946 exceeded $500,000,000, compared with only $83,000,000 in 1939. Mexico has become a much more valuable market for our exports, in large part due to its success in developing its productive resources which in turn has brought generally increased national income and stimulated a greater demand for our goods.

In the Western Hemisphere — an area in which we are so vitally interested — the general economic development of the nations to the south of our borders will increasingly enlarge our total trade. Experience has shown that as those countries become more productive and more prosperous, they will become better markets for United States goods and better partners in the world economy.

If further proof is needed of the close connection between trade and the economic development of individual countries, let us look at the contrasting economic life of Europe and Asia. The greater part of the world's trade before the war was not between the poor under-developed colonial areas on the one hand and the industrialized western world on the other. Much more important was the volume of trade among the countries in the Western European and North Atlantic group of nations. It was the experience of these nations that the industrialization and general development of their neighbors invariably increased their own trade and the benefits they derived therefrom.

Industrial progress in our modern world is not the same as self-sufficiency. Instead, it usually means a fuller measure of cooperation and an increase of mutually profitable trade in goods and services.

So our interest lies not in attempting to hold down our neighbors to the status of suppliers of raw materials, but rather in lending them a helping hand, in making available our capital resources and our technological knowledge. In this way, we may share in supplying the increased demand for goods created by expanding national incomes.

Through judicious loans and investment, our Government and our industries have been making an effective contribution to the development of the Latin American Republics. The economic potentialities of our sister republics are limitless, and their growth will bring a mutually beneficial expansion of our foreign trade.

At the Conference now meeting in Havana, this country is taking the lead in putting the finishing touches on the Charter for an International Trade Organization. This organization is designed to encourage international trade and sound economic development among all member nations. Your city and your state, with their far-flung trading activities, have a real stake in these efforts to substitute a rule of reason and common interest for cut-throat competitive economic nationalism in the trade relations between countries.

These then, are among the elements of great strength in our country today. We have vast physical resources upon which we can count if we conserve and use them wisely. We have a virile and intelligent citizenry possessed of energy and a sense of community spirit. Our domestic and foreign trading system assures us maximum benefit from the interchange of goods and services on which our high standard of living depends.

Most of the so-called obstacles to continuing economic well-being will disappear if we will submerge immediate self-interests and concentrate on long-range advantages -- if we will appraise our present problems realistically and seek to solve them through the united effort of government, management, capital, labor and agriculture.

During the war it was necessary for Government to step into production and markets to ensure the adequate supply of materials required to prosecute the war. But now that hostilities have ended, we have returned to a system of private enterprise. We look to American business to expand its production. And to date, American business has made magnificent progress in this direction.

For our factories are turning out the highest volume of production since the war -- much higher than in any previous peacetime year. The Federal Reserve Board's index of industrial production stood at 189 in October, as compared with 113 in 1937, the highest yearly average prior to the outbreak of the war in Europe.

The volume of freight carried by the railroads is at a new high peacetime level.

Agriculture production is at record heights.

The nation has more people employed in civilian occupations than ever before in history.

Electric power output reached the highest level on record last month.

Crude oil production reached a record peak during the last weeks of October.

New homes started in September and October are estimated at 92,000 in each month. These figures are apparently the highest on record for the months mentioned.

These present indices of prosperity measured along with our prospects for industrial replacement and expansion, our road building programs, our municipal construction and the urgent demand for housing, form a tremendous backlog of business activity for future years.

I am not trying to paint an over-optimistic picture, but I do believe that if we take full advantage of these favorable conditions, the American system of free enterprise can carry us forward to new heights of sound prosperity, based on full production, wide distribution of goods, and expanding trade.

But, in assuring our national economic welfare, the Government of the United States has a very real responsibility and obligation. Our government must, without question, and particularly in these momentous times, retain a strong financial position. Such has been the primary fiscal objective of President Truman, and, as Secretary of the Treasury, I have sought always to work toward that goal.

One of the most effective steps we can take in government towards fiscal soundness would be an equitable revision of our tax structure, which today does not fully meet the requirements of our modern expanding economy.

Many elements in the present tax system were adopted under conditions vastly different from those which confront us currently. Some of these measures were adopted during depression conditions; others during the extraordinary circumstances of war.

During the past years, when we were striving to increase Federal revenues, first to prepare for, and later to fight, the costliest war in history, we were compelled to give high priority to those measures of taxation that would bring in sufficient revenue. Of necessity, adequate attention could not be given to considerations of equity and to the incentives which would be needed after the war for the expansion of American industry and trade.

But, we must now devise a strong balanced tax program. We need a tax system that will not deter the American public from providing markets for this expansion.

In meeting this need, the Congress must resolve many difficult questions. For example, what specifically is there in the present tax system that lies in the path of continuing expansion of American business and industry? What is there in the present tax system which, if unchanged, would sooner or later interfere with expanding markets for the products of American industry? What are some of the inequities which have crept into the American tax system and, tolerable during conditions of war, should now be eradicated?

In the Treasury we have devoted a great deal of time and study to provide the American public and the Congress with the best answers to these questions.

To date we have released twelve major tax studies; fifteen others are in process and are scheduled for release during the next several months.

I believe that it would be well to repeat here those fundamental principles of a sound tax structure which I stated before the Ways and Means Committee on May 19, 1947, as follows:

"The tax system should produce adequate revenue. It should be equitable in its treatment of different groups. It should interfere as little as possible with incentives to work and to invest. It should help maintain the broad consumer markets that are essential for high-level production and employment. Taxes should be as simple to administer and as easy to comply with as possible. While the tax system should be flexible and change with changing economic conditions, it should be possible to achieve this flexibility without frequent revisions of the basic tax structure. A stable tax structure, with necessary flexibility confined largely to changes in tax rates and exemptions, will make it easier for business and Government to plan for the future."

The complex excise tax structure is among the matters which will require especial attention in the process of modernizing the tax system to make it compatible with the continued expansion of American business and industry.

Some of the present excises enter into business costs and operate to disturb competitive relations. An outstanding example is the tax on transportation of freight. Other excises produce either unimportant amounts of revenue or are unduly burdensome on individuals with low incomes. Still others would, under less favorable business conditions, make it difficult to carry on profitable enterprises.

While it is true that the existing excise tax system has not been detrimental to business during the war and postwar inflationary period, I believe that under more normal conditions it could not be continued without harmful effects.

I further believe that in revising the tax system it is important to bring about greater equalization in the taxation of business income regardless of the legal forms of organization. Present law produces important differences in tax burden on business income, depending upon whether it is conducted in the form of an unincorporated or an incorporated business. While complete uniformity may prove to be neither desirable nor practicable, some greater degree of equalization would appear to be attainable. In this connection attention should be given to the problem which has received so much discussion in recent months, namely, the double taxation of dividends.

There is not sufficient time to discuss all of the important elements of a fiscal and tax policy which I believe would have the maximum salutary effect upon our domestic economy. There is one other phase, however, which I would emphasize.

As Secretary of the Treasury, I must consistently and forcibly advocate the policy of providing sufficient revenues to meet current obligations and to permit steady liquidation of the public debt.

The United States Treasury closed its last fiscal year with a surplus for the first time in 17 years. Certainly during this present period of prosperity, we should maintain a balanced budget with adequate provision for debt reduction.

It is a sobering thought that although our public debt has been materially reduced from its peak, it still remains at the staggering figure of $258,000,000,000.

The public debt of the United States is a contract between the government and the people of this country. Government bonds are held by individuals, by insurance companies, by banks, by educational and charitable foundations. We must not weaken public confidence in government obligations by ignoring our debt at a time when we should reduce it.

I want to make it perfectly clear that I am not opposed to tax reduction. I believe tax reduction feasible and proper after we have met certain necessary prerequisite obligations.

In closing, I would like to restate my strong conviction that a financially sound government is the first requisite to permanent welfare and is the keystone to the security of a people.

I am convinced that before reaching conclusions on tax reduction, the Congress should first consider foreign aid within a balanced budget; second, debt reduction; and third, equitable tax revision.

When the necessary prerequisites have been met, tax reduction will become feasible and proper.

We must remain a nation strong economically, strong financially, and strong in the determination to exercise our responsibilities of leadership.

Devotion to the principles of a free democracy has been the compelling force behind the progress of our system of enterprise. And, under the continued guidance of these principles, we will persevere as a powerful influence for worldwide economic stability and genuine world peace.

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TREASURY DEPARTMENT

Washington

FOR IMMEDIATE RELEASE,
Thursday, December 4, 1947

Press Service
No. S-550

Secretary Snyder today announced the appointment of John W. Gunter as Deputy Director, Office of International Finance.

Mr. Gunter was born on February 17, 1914, in Sanford, North Carolina, and attended the University of North Carolina, receiving a Ph.D. degree from that institution.

Mr. Gunter has been employed by the Treasury Department for the past 7 years, and since 1943 has served as a Treasury representative in various overseas posts. His most recent assignment was in London, England, and his family is residing there at the present time.

Prior to his appointment in the Treasury Department, Mr. Gunter served as an Instructor at the University of North Carolina.

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TREASURY DEPARTMENT

Washington

FOR RELEASE, MORNING NEWSPAPERS,
Friday, December 5, 1947.

Press Service
No. S-551

The Secretary of the Treasury, by this public notice, invites tenders for $1,200,000,000, or thereabouts of 91-day Treasury bills, for cash and in exchange for Treasury bills maturing December 11, 1947, to be issued on a discount basis under competitive and non-competitive bidding as hereinafter provided. The bills of this series will be dated December 11, 1947, and will mature March 11, 1948, when the face amount will be payable without interest. They will be issued in bearer form only, and in denominations of $1,000, $5,000, $10,000, $100,000, $500,000, and $1,000,000 (maturity value).

Tenders will be received at Federal Reserve Banks and Branches up to the closing hour, two o'clock p.m., Eastern Standard time, Monday, December 8, 1947. Tenders will not be received at the Treasury Department, Washington. Each tender must be for an even multiple of $1,000, and in the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e. g., 99.925. Fractions may not be used. It is urged that tenders be made on the printed forms and forwarded in the special envelopes which will be supplied by Federal Reserve Banks or Branches on application therefor.

Tenders will be received without deposit from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. Tenders from others must be accompanied by payment of 2 percent of the face amount of Treasury bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incroporated bank or trust company.

Immediately after the closing hour, tenders will be opened at the Federal Reserve Banks and Branches, following which public announcement will be made by the Secretary of the Treasury of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection thereof. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and his action in any-such respect shall be final. Subject to these reservations, non-competitive tenders for $200,000 or less without stated price from any one bidder will be accepted in full at the average price (in three decimals) of accepted competitive bids. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank on December 11, 1947, in cash or other immediately available funds or in a like face amount of Treasury bills maturing December 11, 1947. Cash and exchange tenders will receive equal treatment. Cash adjustments will be made for differences between the par value of maturing bills accepted in exchange and the issue price of the new bills.

The income derived from Treasury bills, whether interest or gain from the sale or other disposition of the bills, shall not have any exemption, as such, and loss from the sale or other disposition of Treasury bills shall not have any special treatment, as such, under the Internal Revenue Code, or laws amendatory or supplementary thereto. The bills shall be subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but shall be exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority. For purposes of taxation the amount of discount at which Treasury bills are originally sold by the United States shall be considered to be interest. Under Sections 42 and 117 (a) (1) of the Internal Revenue Code, as amended by Section 115 of the Revenue Act of 1941, the amount of discount at which bills issued hereunder are sold shall not be considered to accrue until such bills shall be sold, redeemed or otherwise disposed of, and such bills are excluded from consideration as capital assets. Accordingly, the owner of Treasury bills (other than life insurance companies) issued hereunder need include in his income tax return only the difference between the price paid for such bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made, as ordinary gain or loss.

Treasury Department Circular No. 418, as amended, and this notice, prescribe the terms of the Treasury bills and govern the conditions of their issue. Copies of the circular may be obtained from any Federal Reserve Bank or Branch.

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TREASURY DEPARTMENT

Washington

FOR RELEASE, MORNING NEWSPAPERS
Saturday, December 6, 1947.

Press Service
No. S-552

Secretary Snyder today released an exchange of letters between himself and Sir Stafford Cripps, the Chancellor of the Exchequer of the United Kingdom, whereby it is agreed that it is now appropriate for the United Kingdom to resume withdrawals against the line of credit established by the Anglo-American Financial Agreement of December 6, 1945.

In reviewing the events leading to this exchange of letters, Secretary Snyder recalled that withdrawals against the credit were temporarily discontinued in August on the basis of a mutual agreement between the two Governments. The action was taken simultaneously with the instituting of emergency steps by the United Kingdom to stop an unanticipated and excessive drain on her resources which followed the granting of free convertibility of sterling in July.

Secretary Snyder cautioned however that while progress had been made toward the working out of a satisfactory program dealing with the convertibility of sterling, the serious economic conditions existing in the world would delay for some time the restoration of full convertibility. In this connection he pointed out that there are, however, no restrictions on the convertibility of sterling held in current accounts of United States residents.

Secretary Snyder stated that the resumption of drawings against the line of credit at this time would permit the United Kingdom to continue the purchases in the United States necessary to maintain its present austerity program and hence would not add to inflationary pressures in this country.

Attached are the texts of letters exchanged by Secretary Snyder and Chancellor Cripps.

Treasury Chambers
Great George Street
London, S. W. 1

4th December, 1947

My dear Mr. Secretary:

I refer to the exchange of letters of August 20, 1947, between our two Governments and to the discussions pertaining thereto whereby it was agreed that for a temporary period His Majesty's Government would not notify any further withdrawals against the line of credit established under the Anglo-American Financial Agreement, and it was contemplated that consultation would be undertaken with respect to a constructive program which would be best calculated to achieve the objectives of the Agreement and at the same time to conserve British dollar resources in this critical period.

As you know, representatives of our two Treasuries have been in frequent consultation and considerable progress has been made toward these ends. Accordingly it now appears to me appropriate for His Majesty's Government to resume drawings against the line of credit.

I should like to take this opportunity to reaffirm the intention of His Majesty's Government to adhere as closely as possible to the objectives of the Agreement at all times and to implement these objectives fully at the earliest possible time.

Yours sincerely,

/S/ STAFFORD CRIPPS

Chancellor of the Exchequer

Honorable John W. Snyder
Secretary of the Treasury
Washington 25, D. C.

December 5, 1947

My dear Chancellor:

I have your letter of December 4, 1947 advising me of the desire of His Majesty's Government to resume withdrawals against the line of credit established under the Anglo-American Agreement of December 6, 1945. The frequent consultations between the representatives of our two Treasuries lead me to confirm your understanding that, as contemplated in the August 20 exchange of letters between our two Governments and the discussions pertaining thereto, it is now appropriate for your Government to resume drawings against the line of credit.

I am pleased to receive your reaffirmation of the intention of your Government to implement fully at the earliest possible time the principles embodied in the Anglo-American Agreement and to adhere to them as closely as possible at all times.

Sincerely yours,

/S/ JOHN W. SNYDER
Secretary of the Treasury

Right Honorable Sir Stafford Cripps, P.C., M.P.
Chancellor of the Exchequer
Treasury Chambers
London, England

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STATUTORY DEBT LIMITATION
AS OF NOVEMBER 30, 1947

December 5, 1947

Section 21 of the Second Liberty Bond Act, as amended, provides that the face amount of obligations issued under authority of that Act, and the face amount of obligations guaranteed as to principal and interest by the United States (except such guaranteed obligations as may be held by the Secretary of the Treasury), "shall not exceed in the aggregate $275,000,000,000 outstanding at any one time. For purposes of this section the current redemption value of any obligation issued on a discount basis which is redeemable prior to maturity at the option of the holder shall be considered as its face amount."

The following table shows the face amount of obligations outstanding and the face amount which can still be issued under this limitation:

Total face amount that may be outstanding at any one time			$275,000,000,000
Outstanding November 30, 1947			
Obligations issued under Second Liberty Bond Act, as amended			
Interest-bearing			
Treasury bills..............	$ 15,334,892,000		
Certificates of indebtedness	24,500,502,000		
Treasury notes.............	13,373,508,400	$ 53,208,902,400	
Bonds			
Treasury..................	118,563,915,150		
Savings (current redemp. value)	52,008,036,135		
Depositary...............	320,422,000		
Armed Forces Leave........	838,037,025		
Investment Series.........	969,960,000	172,700,370,310	
Special Funds			
Certificates of indebtedness	14,811,100,000		
Treasury notes............	14,705,434,000	29,516,534,000	
Total interest-bearing..................		255,425,806,710	
Matured, interest-ceased....................		240,758,325	
Bearing no interest			
War savings stamps..........	63,793,226		
Excess profits tax refund bonds	12,660,000		
Special notes of the United States:			
Internat'l Bank for Reconst. and Development series....	265,785,000		
Internat'l Monetary Fund Series	1,345,000,000	1,687,238,226	
Total..................................		257,353,803,261	
Guaranteed obligations (not held by Treasury)			
Interest-bearing			
Debentures: F.H.A.	32,951,386		
Demand obligations C.C.C. ...	50,520,802	83,472,188	
Matured, interest-ceased....................		5,601,675	
		89,073,863	
Grand total outstanding.........................			257,442,877,124
Balance face amount of obligations issuable under above authority....			17,557,122,876

Reconcilement with Statement of the Public Debt - November 30, 1947
(Daily Statement of the United States Treasury, December 1, 1947)

Outstanding -	
Total Gross public debt..	258,211,995,228
Guaranteed obligations not owned by the Treasury.................	89,073,863
Total gross public debt and guaranteed obligations...............	258,301,069,091
Deduct - other outstanding public debt obligations not subject to debt limitation..............................	858,191,967
	257,442,877,124

S-553

TREASURY DEPARTMENT
Washington

FOR IMMEDIATE RELEASE,
Friday, December 5, 1947.

Press Service
No. S-554

George J. Schoeneman, Commissioner of Internal Revenue, in response to requests from many corporations which determine their dividend policies at this time of year, today made the following statement of administrative policy with regard to Section 102 of the Internal Revenue Code:

"The ordinary practice of profit-making corporations is to retain, each year, whatever surplus is reasonably needed for the business, distributing the remainder to stockholders in the form of dividends. Such policies do not conflict with any provision of the Internal Revenue Code and do not subject any corporation to the additional tax provided by Section 102. The applicability of Section 102 is not based upon the retention of any percentage of profits but rather upon the retention of profits in excess of the reasonable requirements of the particular business. In view of some apparent misinformation and unjustified apprehension as to the administration of Section 102, it may be helpful to state again what has been the long-established policy of the Bureau of Internal Revenue.

"Section 102, or a substantially equivalent provision, has been in the income tax law ever since the modern income tax was adopted in 1913. It never has been and is not now the policy of the Bureau of Internal Revenue to apply this provision to any corporation unless it withholds from its stockholders surplus earnings clearly in excess of the reasonable needs of the business and for the purpose of enabling stockholders to avoid personal income taxes. In determining whether surplus is retained for business purposes, it is our unvarying policy to give due consideration to the judgment of the corporation's own management as to what sums are needed for working capital, expansion of facilities, sinking funds for debt retirement, contigency funds to cover employee benefits, and similar bona fide business and legal needs. In all questionable cases, it is our policy to give the corporation's management an opportunity to explain the purpose of its surplus retention before applying Section 102. We believe the administrative record of the past 35 years provides ample assurance that Section 102 has not been, and is not being, applied so as to affect adversely the bona fide operation or conduct of any business.

"To some extent, misunderstanding appears to have arisen because the 1946 corporate tax return asked corporations to state whether they had distributed at least 70 percent of their earnings to stockholders. This question has been deleted for the 1947 return. The Bureau of Internal Revenue used this 70 percent figure only as a convenient method of selecting corporation income tax returns for examination, but under no circumstances does it use this, or any other percentage, as a measure for liability under Section 102."

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TREASURY DEPARTMENT

Washington

FOR RELEASE, MORNING NEWSPAPERS,
Tuesday, December 9, 1947.

Press Service
No. S-555

The Secretary of the Treasury announced last evening that the tenders for $1,200,000,000, or thereabouts, of 91-day Treasury bills to be dated December 11, 1947, and to mature March 11, 1948, which were offered December 5, 1947, were opened at the Federal Reserve Banks on December 8.

The details of this issue are as follows:

Total applied for - $1,616,937,000
Total accepted - 1,201,938,000 (includes $42,769,000 entered on a non-competitive basis and accepted in full at the average price shown below)

Average price - 99.760 Equiv. rate of discount approx. 0.948% per annum

Range of accepted competitive bids: (Excepting one tender of $400,000)

High - 99.770 Equiv. rate of discount approx. 0.910% per annum
Low - 99.759 " " " " " 0.953% " "

(21 percent of the amount bid for at the low price was accepted)

Federal Reserve District	Total Applied for	Total Accepted
Boston	$ 2,910,000	$ 2,910,000
New York	1,475,699,000	1,086,789,000
Philadelphia	8,703,000	8,703,000
Cleveland	3,700,000	2,673,000
Richmond	4,769,000	4,569,000
Atlanta	1,505,000	1,505,000
Chicago	59,643,000	35,138,000
St. Louis	5,409,000	5,409,000
Minneapolis	4,265,000	4,028,000
Kansas City	13,218,000	13,108,000
Dallas	8,785,000	8,775,000
San Francisco	28,331,000	28,331,000
TOTAL	$1,616,937,000	$1,201,938,000

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TREASURY DEPARTMENT
Washington

FOR RELEASE, MORNING NEWSPAPERS
Wednesday, December 10, 1947.

Press Service
No. S-556

George J. Schoeneman, Commissioner of Internal Revenue, announced today rules for determining bad debt reserves for the calendar year 1947 and subsequent taxable years in the case of banks which use the reserve system of computing bad debts deductions for income tax purposes.

Under instructions issued today to field offices of the Bureau of Internal Revenue, these banks will be permitted to compute their deductions for bad debt reserves for each of such years on the basis of the average losses of twenty years, provided that no additions to the reserves may be made that will result in the total of such reserves exceeding three times an amount calculated by multiplying the oustanding loans at the end of the taxable year by the average ratio of bad debt losses to outstanding loans during the same twenty year period. Heretofore, the practice has been to use a shorter period of time, often five years, in computing such reserves.

In order to enable banks to adopt this system for the calendar year 1947, Commissioner Schoeneman also announced that the income tax regulations are being amended to permit eligible banks to choose this plan for 1947 if they do so by March 15, 1948. If the bank files its annual income tax return by that date, it may prepare the return on the new basis and attach an explanation of its action, without making formal request for permission to change its accounting methods. Otherwise, the usual request must be made before changing accounting methods.

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TREASURY DEPARTMENT
Washington

FOR IMMEDIATE RELEASE
December 10, 1947

Press Service
No. S-557

The Bureau of Customs announced today preliminary figures showing the imports for consumption of commodities within quota limitations provided for under trade agreements, from the beginning of the quota periods to November 29, 1947, inclusive, as follows:

Commodity	Established Quota Period and Quantity		Unit of Quantity	Imports as of Nov. 29 1947
Whole Milk, fresh or sour	Calendar year	3,000,000	Gallon	6,915
Cream, fresh or sour	Calendar year	1,500,000	Gallon	1,652
Fish, fresh or frozen, filleted, etc., cod, haddock, hake, pollock, cusk, and rosefish	Calendar year	23,906,423	Pound	Quota filled
White or Irish potatoes:				
Certified seed	12 months from	90,000,000	Pound	27,365,680
Other	Sept. 15, 1947	60,000,000	Pound	27,201,010
Cuban filler tobacco unstemmed or stemmed (other than cigarette leaf tobacco) and scrap tobacco	Calendar year	22,000,000	Pound (unstemmed equivalent)	Quota Filled
Red cedar shingles	Calendar year	1,380,300	Square	Quota filled
Molasses and sugar sirups containing soluble non-sugar solids equal to more than 6% of total soluble solids	Calendar year	1,500,000	Gallon	580,550

TREASURY DEPARTMENT
Washington

FOR IMMEDIATE RELEASE
December 10, 1947

Press Service
No. S-558

The Bureau of Customs announced today preliminary figures showing the quantities of wheat and wheat flour entered, or withdrawn from warehouse, for consumption under the import quotas established in the President's proclamation of May 28, 1941, as modified by the President's proclamations of April 13, 1942, and April 29, 1943, for the 12 months commencing May 29, 1947, as follows:

Country of Origin	Wheat		Wheat flour, semolina, crushed or cracked wheat, and similar wheat products	
	Established Quota	Imports May 29, 1947, to Nov. 29, 1947	Established Quota	Imports May 29, 1947, to Nov. 29, 1947
	(Bushels)	(Bushels)	(Pounds)	(Pounds)
Canada	795,000	112	3,815,000	1,107,892
China	-	-	24,000	6,000
Hungary	-	-	13,000	-
Hong Kong	-	-	13,000	160
Japan	-	-	8,000	-
United Kingdom	100	-	75,000	-
Australia	-	-	1,000	-
Germany	100	-	5,000	-
Syria	100	-	5,000	-
New Zealand	-	-	1,000	-
Chile	-	-	1,000	-
Netherlands	100	-	1,000	-
Argentina	2,000	-	14,000	-
Italy	100	-	2,000	-
Cuba	-	-	12,000	-
France	1,000	-	1,000	-
Greece	-	-	1,000	-
Mexico	100	-	1,000	-
Panama	-	-	1,000	-
Uruguay	-	-	1,000	-
Poland and Danzig	-	-	1,000	-
Sweden	-	-	1,000	-
Yugoslavia	-	-	1,000	-
Norway	-	-	1,000	-
Canary Islands	-	-	1,000	-
Rumania	1,000	-	-	-
Guatemala	100	-	-	-
Brazil	100	-	-	-
Union of Soviet Socialist Republics	100	-	-	-
Belgium	100	-	-	-
	800,000	112	4,000,000	1,114,052

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TREASURY DEPARTMENT
Washington

FOR IMMEDIATE RELEASE
Wednesday, December 10, 1947

Press Service
No. S-559

The Bureau of Customs annouced today preliminary figures showing the imports for consumption of commodities on which quotas were prescribed by the Philippine Trade Act of 1946, from January 1, 1947, to November 29, 1947, inclusive, as follows:

Products of Philippine Islands	Established Quota Quantity	Unit of Quantity	Imports as of November 29, 1947
Buttons	850,000	Gross	86,412
Cigars	200,000,000	Number	3,206,554
Coconut Oil	448,000,000	Pound	16,908,601
Cordage	6,000,000	"	2,211,227
Rice	1,040,000	"	50
Sugars, refined) unrefined)	1,904,000,000	"	-
Tobacco	6,500,000	"	1,085,381

TREASURY DEPARTMENT
Washington

FOR IMMEDIATE RELEASE
Wednesday, December 10, 1947

Press Service
No. S-560

The Bureau of Customs announced today that preliminary data on imports of cotton and cotton waste chargeable to the quotas established by the President's proclamation of September 5, 1939, as amended, for the period September 20, 1947, to November 29, 1947, inclusive, are as follows:

COTTON (other than linters)
(In pounds)

Country of Origin	Under 1-1/8" other than rough or harsh under 3/4"		1-1/8" or more but less than 1-11/16" 4/	Less than 3/4" harsh or rough 5/
	Established Quota	Imports Sept. 20,1947, to Nov. 29,1947	Imports Sept. 20,1947, to Nov. 29,1947	Imports Sept. 20, 1947, to Nov. 29, 1947
Egypt and the Anglo-Egyptian Sudan	783,816	-	43,574,472	-
Peru	247,952	186,962	1,903,999	-
British India	2,003,483	-	-	6,810,505
China	1,370,791	-	-	-
Mexico	8,883,259	8,883,259	-	-
Brazil	618,723	618,723	-	-
Union of Soviet Socialist Republics	475,124	249,068	177,949	-
Argentina	5,203	-	-	-
Haiti	237	-	-	-
Ecuador	9,333	-	-	-
Honduras	752	-	-	-
Paraguay	871	-	-	-
Colombia	124	-	-	-
Iraq	195	-	-	-
British East Africa	2,240	-	-	-
Netherlands East Indies	71,388	-	-	-
Barbados	-	-	-	-
Other British West Indies 1/	21,321	-	-	-
Nigeria	5,377	-	-	-
Other British West Africa 2/	16,004	-	-	-
Other French Africa 3/	689	-	-	-
Algeria and Tunisia	-	-	-	-
	14,516,882	9,938,012	45,656,420	6,810,505

1/ Other than Barbados, Bermuda, Jamaica, Trinidad, and Tobago.
2/ Other than Gold Coast and Nigeria.
3/ Other than Algeria, Tunisia, and Madagascar.
4/ Established Quota - 45,656,420.
5/ Established Quota - 70,000,000.

COTTON WASTES
(In pounds)

COTTON CARD STRIPS made from cotton having a staple of less than 1-3/16 inches in length, COMBER WASTE, LAP WASTE, SLIVER WASTE, AND ROVING WASTE, WHETHER OR NOT MANUFACTURED OR OTHERWISE ADVANCED IN VALUE: Provided, however, that not more than 33-1/3 percent of the quotas shall be filled by cotton wastes other than comber wastes made from cottons of 1-3/16 inches or more in staple length in the case of the following countries: United Kingdom, France, Netherlands, Switzerland, Belgium, Germany, and Italy:

Country of Origin	Established TOTAL QUOTA	Total imports Sept. 20, 1947, to Nov. 29, 1947	Established 33-1/3% of Total Quota	Imports Sept. 20 1947, to Nov. 29, 1947 1/
United Kingdom.......	4,323,457	-	1,441,152	-
Canada..............	239,690	60,534	-	-
France.............	227,420	-	75,807	-
British India........	69,627	69,627	-	-
Netherlands..........	68,240	-	22,747	-
Switzerland..........	44,388	-	14,796	-
Belgium..............	38,559	-	12,853	-
Japan................	341,535	-	-	-
China................	17,322	-	-	-
Egypt................	8,135	-	-	-
Cuba.................	6,544	-	-	-
Germany..............	76,329	-	25,443	-
Italy................	21,263	-	7,088	-
Totals	5,482,509	130,161	1,599,886	-

1/ Included in total imports, column 2.

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TREASURY DEPARTMENT
Washington

FOR RELEASE MORNING NEWSPAPERS,
Monday, December 15, 1947.

Press Service
No. S-561

The Treasury Department today made public a report showing the results of a census of American-owned assets in foreign countries, taken in 1943 by the Department's office of Foreign Funds Control.

In the foreword of the report, Secretary Snyder points out that for the first time the real size and scope of American-owned assets in foreign countries is made available to the public. The detailed data appended to the study, he continues, should prove "invaluable to businessmen and students interested in the problems of international trade and finance."

The total of foreign assets owned in the United States as of the census date - May 31, 1943 - was $13,542,000,000, the report released today sets forth. Included were such assets as investments in American-controlled enterprises, securities, bank deposits, interests in estates and trusts, and numerous other types of property.

Investments in American-controlled foreign enterprises, engaged in all major types of business and located in all parts of the world, comprised more than half of the value of American-owned foreign assets. Holdings of foreign securities accounted for another one-fourth of the total; holdings of foreign dollar bonds amounted to $1,564,000,000, and foreign stocks and other issues payable in foreign currencies totaled $2,105,000,000. The latter figure exceeded all previous estimates in both the volume and the number of countries involved.

American interests in Canadian assets, which amounted to $4,446,000,000, were four times as much as those in any other country, and the equivalent of the total in Europe, valued at $4,418,000,000. Half of these European assets was about evenly divided between Germany and the United Kingdom. Assets in Latin America aggregated $3,535,000,000, and those in the rest of the world, $1,142,000,000.

As a result of extensive efforts to reach all United States citizens and individuals who hold foreign assets, more than 220,000 business concerns and individuals filed reports with the Treasury Department on Form TFR-500. Of the 168,000 individuals reporting, 27,000 were citizens of foreign countries, two-thirds of whom had entered this country after 1937. Individuals owned $3,570,000,000 of the assets; approximately 12,000 corporations and other profit organizations accounted for $8,866,000,000, while estates, trusts and non-profit organizations owned $1,106,000,000.

The owners of foreign assets, it was pointed out, were located in every State in the United States, the District of Columbia, Alaska, the Canal Zone, Hawaii, Puerto Rico, and the Virgin Islands. In addition, close to 3,600 United States citizens in foreign countries reported their holdings.

New York State led, with 58,605 owners, or 30 percent of the total number, reporting assets aggregating $7,590,000,000, or 56 percent of the total amount. The report notes the tendency of corporations with substantial interests in foreign trade and investment to concentrate in New York.

Among the States, the smallest in number of reporters was Nevada, and the smallest in value of assets was Wyoming. The latter was followed closely by South Dakota, Mississippi, Idaho and North Dakota, these states having foreign assets ranging in value from $1,500,000 to $2,900,000. In contrast, between $575,000,000 and $645,000,000 of foreign property was held by owners located in each of the following states: Pennsylvania, Massachusetts, California, New Jersey and Illinois.

An analysis of the creditor-debtor position of the United States, 1939-1946, appears in chapter two of the report, indicating that the United States was a net creditor to the amount of $1,100,000,000 at the end of 1939. At the end of 1946 the United States was a net creditor to the extent of $4,800,000,000, but only because of the inclusion of obligations due to, and other foreign assets of, the United States Government. Exclusive of these Government loans and assets, this country was a net creditor by about $240,000,000 at the end of 1946.

The "Census of American-Owned Assets in Foreign Countries", based on reports on Treasury Form TFR-500, is in booklet form, and may be purchased from the Superintendent of Documents, Government Printing Office. Its chapters set forth the background of the census, a description of its nature and scope, and the salient facts developed out of the census data. In its appendix are basic tables, presenting the available data in detail.

An earlier study, "Census of Foreign-Owned Assets in the United States," based on reports submitted on Form TFR-300 in 1941, was released to the public in February, 1946. The two censuses were of great usefulness in connection with the freezing controls administered by the Treasury during the war period, and in Allied preparation for peace negotiations.

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TREASURY DEPARTMENT

Washington

FOR RELEASE, MORNING NEWSPAPERS, Friday, December 12, 1947.

Press Service No. S-562

The Secretary of the Treasury, by this public notice, invites tenders for $1,300,000,000, or thereabouts, of 91-day Treasury bills, for cash and in exchange for Treasury bills maturing December 18, 1947, to be issued on a discount basis under competitive and non-competitive bidding as hereinafter provided. The bills of this series will be dated December 18, 1947, and will mature March 18, 1948, when the face amount will be payable without interest. They will be issued in bearer form only, and in denominations of $1,000, $5,000, $10,000, $100,000, $500,000, and $1,000,000 (maturity value).

Tenders will be received at Federal Reserve Banks and Branches up to the closing hour, two o'clock p.m., Eastern Standard time, Monday, December 15, 1947. Tenders will not be received at the Treasury Department, Washington. Each tender must be for an even multiple of $1,000, and in the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e. g., 99.925. Fractions may not be used. It is urged that tenders be made on the printed forms and forwarded in the special envelopes which will be supplied by Federal Reserve Banks or Branches on application therefor.

Tenders will be received without deposit from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. Tenders from others must be accompanied by payment of 2 percent of the face amount of Treasury bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

Immediately after the closing hour, tenders will be opened at the Federal Reserve Banks and Branches, following which public announcement will be made by the Secretary of the Treasury of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection thereof. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and his action in any such respect shall be final. Subject to these reservations, non-competitive tenders for $200,000 or less without stated price from any one bidder will be accepted in full at the average price (in three decimals) of accepted competitive bids. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank on December 18, 1947, in cash or other immediately available funds or in a like face amount of Treasury bills maturing December 18, 1947. Cash and exchange tenders will receive equal treatment. Cash adjustments will be made for differences between the par value of maturing bills accepted in exchange and the issue price of the new bills.

The income derived from Treasury bills, whether interest or gain from the sale or other disposition of the bills, shall not have any exemption, as such, and loss from the sale or other disposition of Treasury bills shall not have any special treatment, as such, under the Internal Revenue Code, or laws amendatory or supplementary thereto. The bills shall be subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but shall be exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority. For purposes of taxation the amount of discount at which Treasury bills are originally sold by the United States shall be considered to be interest. Under Sections 42 and 117 (a) (1) of the Internal Revenue Code, as amended by Section 115 of the Revenue Act of 1941, the amount of discount at which bills issued hereunder are sold shall not be considered to accrue until such bills shall be sold, redeemed or otherwise disposed of, and such bills are excluded from consideration as capital assets. Accordingly, the owner of Treasury bills (other than life insurance companies) issued hereunder need include in his income tax return only the difference between the price paid for such bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made, as ordinary gain or loss.

Treasury Department Circular No. 418, as amended, and this notice, prescribe the terms of the Treasury bills and govern the conditions of their issue. Copies of the circular may be obtained from any Federal Reserve Bank or Branch.

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TREASURY DEPARTMENT

Washington

FOR IMMEDIATE RELEASE
Thursday, December 11, 1947

Press Service
No. S-563

On December 11th the Treasury received the sum of $260,852.24 from the Government of Finland, representing a payment of principal in the amount of $96,000, and the semi-annual payment of interest in the amount of $130,025.00 under the Funding Agreement of May 1, 1923; $13,695.06 on account of the semi-annual payment on the annuity due under the postponement agreement of May 1, 1941, and $21,132.18 on account of the semi-annual payment on the annuity due under the postponement agreement of October 14, 1943.

These payments represent the entire amount due from the Government of Finland on December 15, 1947, under these agreements.

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TREASURY DEPARTMENT

Washington

FOR IMMEDIATE RELEASE
Friday, December 12, 1947

Press Service
No. S-564

Secretary of the Treasury Snyder, on behalf of the National Advisory Council, today issued the following statement:

The United States Government welcomes the statement of the International Monetary Fund respecting measures to subsidize the production of gold. The expressed intention of the Fund to keep under review the gold policies of its members in the light of a sound international gold policy is an important forward step in the field of international financial cooperation.

The United States, as the largest gold buying country, has a peculiar and continuing interest in the role which gold subsidies may come to play in the production, movement, and price of gold. In particular, the United States would view with disfavor any tendency for countries to become dependent on subsidized gold production as a solution to the problem of arriving at and maintaining equilibrium in their balances of international payments.

In the view of the Council there are no grounds which would justify instituting a subsidy to encourage the production of gold in this country. The present monetary gold stocks of the United States amount to no less than $22.7 billion. In the first 11 months of 1947 gold purchases by the U. S. from foreign countries amounted to $2.7 billion.

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TREASURY DEPARTMENT

Washington

CORRECTED COPY

FOR RELEASE MORNING NEWSPAPERS
Monday, December 15, 1947

Press Service
No. S-565(a)

During the month of November, 1947, market transactions in direct and guaranteed securities of the Government for Treasury investment and other accounts resulted in net purchases of $220,961,000, Secretary Snyder announced today

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TREASURY DEPARTMENT

Washington

FOR IMMEDIATE RELEASE,
Monday, December 15, 1947.

Press Service
No. S-566

Secretary Snyder today issued the following statement concerning devaluation of the Russian ruble:

> I have seen no official report respecting the currency conversion which, according to press statements, is to be carried out in the U.S.S.R. during the current week.
>
> Currency conversions of a much milder sort have been a part of post-war inflation control in numerous countries, including several non-communist countries of Western Europe. It is interesting to find that the U.S.S.R. is faced with the same problems and must turn to a more severe form of the same device in order to meet them.
>
> These Western European conversions were aimed solely at soaking up excess purchasing power at a time of extreme shortage of goods. They were not linked with action to devalue the currency by changing the foreign exchange rate. So far as can be determined by press reports, this is also true of the projected conversion in Russia.
>
> In fact, if a currency conversion is effective in slowing down inflation, it may reduce pressures leading to devaluation.

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United States Savings Bonds Issued and Redeemed Through November 30, 1947

(Dollar amounts in millions - rounded and will not necessarily add to totals)

	Amount Issued 1/	Amount Redeemed 1/	Amount Outstanding 2/	Percent Redeemed of Amount Issued
Series A-D:				
Series A-1935 (matured)	$ 255	$247	$8	96.86%
Series B-1936 (matured)	463	441	22	95.25
Series C-1937	589	464	3/ 125	78.78
Series C-1938	667	157	510	23.54
Series D-1939	1,032	216	815	20.93
Series D-1940	1,217	233	983	19.15
Series D-1941	524	90	434	17.18
Total Series A-D	4,747	1,849	2,898	38.95
Series E:				
Series E-1941	1,471	341	1,130	23.18
Series E-1942	6,662	2,374	4,288	35.63
Series E-1943	10,909	4,596	6,312	42.13
Series E-1944	12,727	5,477	7,250	43.03
Series E-1945	9,928	4,054	5,873	40.83
Series E-1946	4,358	1,212	3,146	27.81
Series E-1947 (11 months)	3,392	373	3,018	11.00
Total Series E	49,447	18,428	31,018	37.27
Total Series A-E	54,193	20,277	33,916	37.42
Series F and G:				
Series F and G-1941	1,532	202	1,330	13.19
Series F and G-1942	3,189	487	2,702	15.27
Series F and G-1943	3,363	521	2,842	15.49
Series F and G-1944	3,692	434	3,258	11.76
Series F and G-1945	3,145	261	2,884	8.30
Series F and G-1946	2,993	135	2,858	4.51
Series F and G-1947 (11 months).	2,318	17	2,301	.73
Total Series F and G	20,232	2,057	18,175	10.17
Unclassified sales and redemptions	113	165	-52	
Total All Series 4/	74,538	22,500	52,039	30.19

1/ Includes accrued discount.
2/ Current redemption values.
3/ Includes matured bonds which have not been presented for payment.
4/ Includes Series A and B (matured), and therefore does not agree with totals under interest-bearing debt on Public Debt Statement.

Office of Fiscal Assistant Secretary - Treasury Department.

TREASURY DEPARTMENT
Washington

FOR RELEASE MORNING NEWSPAPERS
Friday, December 19, 1947

Press Service
No. S-567

The Treasury Department made public today a staff study entitled "Federal Excise Taxes on Transportation," analyzing factual data believed pertinent to the policy question of whether these taxes should be changed or eliminated in the course of postwar tax revision.

The study presents information as to the rates, the revenue yields, and the economic background of the industries affected by the transportation excises, and discusses the effects of the taxes on profits, on business costs and competition, and on consumers. Administrative and technical problems arising from the taxes also are considered.

Both taxes had World War I histories, but were repealed as of January 1, 1922. They were revived as World War II revenue measures, the tax on transportation of persons in 1941 and that on transportation of property in 1942. The levy on transportation of persons was fixed at 5 percent in 1941, increased to 10 percent in 1942, and increased again to 15 percent in 1943, there being certain exemptions. The rate on transportation of property has been 3 percent ever since the revival of this excise, with a special provision covering transportation of coal.

Revenue yields of the two excises have been similar in amounts. The tax on transportation of persons produced $244,000,000 revenue and that on transportation of property $275,700,000 revenue in the Government's fiscal year 1947.

* * *

As to the tax on transportation of persons, the study says it is doubtful whether the existence of this excise had a significant effect on profits of carriers during the war period. However, it points out, the abnormal wartime experience with the tax does not provide a basis for determining its effect on profits under peacetime conditions.

Prior to the war, only about 15 percent of the intercity passenger mileage was supplied by public transportation facilities subject to tax, the remaining 85 percent representing travel by private automobile.

When the postwar automobile demand becomes satisfied, and other factors affecting demand and supply in the transportation industry have become adjusted to a peacetime basis, it is likely that the present tax would have a significant effect on profits. The increased cost of travel due to the tax probably does not greatly affect business and the most urgent personal travel, but it may materially affect the volume of pleasure travel due to possible substitution of the automobile for other travel means.

Coach travel on the railroads is particularly sensitive to changes in passenger fares, so the prewar history of railroad rates indicates. Because of large fixed costs, a small decrease in railroad passenger revenue can have an important effect on profits. Since railroads are again showing deficits on passenger operations, any reduction in traffic resulting from the tax would add to their difficulties.

Bus travel may be somewhat less sensitive to increases in the cost of transportation, and the possible continuation of an upward trend in this form of travel would tend to offset in part reduction in travel caused by the tax. Similarly, the favorable prospects for expansion of demand for air travel would help to offset the effects of the tax on volume of air traffic and profits.

To the extent that there are differences in the use of taxable transportation facilities by different types of business, the tax discriminates against those types which make the most use of these facilities. The tax also tends to create competitive inequities among the transportation agencies providing different types of service, since it increases price differentials and tends to produce a shift in travel from the higher priced to the lower priced types.

With reference to the effect of the tax on consumers, the study relates that the tax probably constitutes a higher proportion of income for the lower than the higher income groups. The tax on transportation expenditures made by business firms is likely to be reflected in prices paid by consumers in the long run, and thus be distributed regressively in accordance with consumer expenditures.

* * *

It is doubtful whether the tax on transportation of property has had a significant effect on carrier profits up to now, according to the study, since the transportation industries have operated at or near capacity since the tax was imposed. Under more normal conditions the tax probably would have some effect on the volume of traffic and profits.

In view, however, of the probable unresponsiveness of the demand for freight transportation to changes in the cost of such transportation, and the relatively low rate of the present tax, it is doubtful whether continuation of the tax woudl affect profits of the carrier industry very substantially.

The tax tends to increase business costs generally but not uniformly. Moreover, since it applies to shipments of raw materials as well as finished goods, there is considerable opportunity for pyramiding of the tax as goods flow through the various stages of production and distribution.

Although the rate is relatively low, a large volume of total freight is in the form of raw materials where small differences in cost may determine the source of supply to be used. Transportation costs in 1941 amounted to more than half the value of the products at destination in the case of such heavy commodities as gravel, sand and salt, some fresh fruits and certain forest products.

The competitive effects of the tax will be very uneven for business because of the wide variations in the importance of transportation costs by industries and in the location of different firms selling in a common market.

If there is a significant difference in rates between carriers, the tax will widen the difference in favor of the lower priced services. Generally, water and railroad freight rates are lower than truck and express rates.

The tax appears to have a very regressive effect on consumers. Although the tax falls largely on business costs, business will endeavor to pass it on to consumers. The tax probably tends to increase the price of goods more than services. Because consumers in the lower income groups spend a higher proportion of their income for goods than for services, the tax passed on to consumers is probably more regressive than total consumer expenditures.

Statistical tables on passenger and freight traffic and carrier operations accompany the study.

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FEDERAL EXCISE TAXES ON TRANSPORTATION

Part I - Excise Tax on Transportation of Persons

Part II - Excise Tax on Transportation of Property

Division of Tax Research, Treasury Department
December 1947

Federal Excise Taxes on Transportation

One of the important questions in tax revision concerns the changes to be made in the extensive list of excise taxes. This study is one of a series on the commodities and services subject to excise tax. The purpose of the studies is to make available data on tax rates, revenue and the economic background of the industry and to discuss the effects of the tax on profits, on business costs and competition and on consumers. The administration of the tax and the principal technical problems that arise are also considered. The studies are not intended to make policy recommendations but to provide information and analyses which would be useful in appraising the desirability of changing or eliminating the taxes involved.

The study was initially prepared in the Excise Tax Section of the Division of Tax Research. In its preparation valuable assistance and suggestions were received from other members of the Treasury tax staff, including consultation with members of the Office of Tax Legislative Counsel on legal matters and of the Bureau of Internal Revenue on administrative matters.

The general aspects of excise taxes were considered by a committee composed of the technical tax staffs of the Treasury Department and the Joint Committee on Internal Revenue Taxation. The detailed analysis of the individual taxes, however, has been prepared independently and reflects only the views of the Treasury tax staff.

Division of Tax Research
U. S. Treasury Department

December 1947

FEDERAL EXCISE TAXES ON TRANSPORTATION

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PART I - Excise Tax on Transportation of Persons

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TABLES

FEDERAL EXCISE TAXES ON TRANSPORTATION

PART I - Excise Tax on Transportation of Persons

I. Description of the tax

The tax applies to the amounts paid within the United States for transportation of persons by rail, motor vehicle, water or air, and to the amounts paid for sleeping and seating accommodations in connection with such transportation.

The tax is payable by the person making the payment subject to the tax and is collected by the person receiving the payment.

The principal exemptions are:

1. Transportation, any part of which is outside the northern portion of the Western Hemisphere, 1/ except that part of such transportation which is within the United States, Canada or Mexico, or between such countries.

2. Transportation for which the fare does not exceed 35 cents.

3. Commutation or season tickets for single trips of less than 30 miles, or commutation tickets for one month or less.

4. Transportation by motor vehicles having a passenger capacity of less than 10 passengers, including the driver, when not operated on an established line.

1/ The northern portion of the Western Hemisphere means the area lying west of the thirtieth meridian west of Greenwich, east of the International Date Line, and north of the Equator, but not including any country of South America.

5. Amounts paid by State and local governments, the Red Cross and other international organizations.

6. Transportation under special tariffs providing for fares of not more than 1-1/4 cents per mile, applicable to round trip tickets sold to members of the United States armed forces, or members of the armed forces of any of the other United Nations, or authorized cadets and midshipmen traveling at their own expense on official leave. 1/

7. Amounts paid by the United States Government for transportation of persons furnished upon a United States Government travel request. 2/

II. Changes in the tax since 1914

The act of October 22, 1914 levied a stamp tax on the sale of seats or berths in parlor and sleeping cars. A tax on the amount paid for transportation of persons and sleeping and seating accommodations was imposed by the Revenue Act of 1917. The changes in tax rates since 1914 are shown below:

1/ Not applicable to amounts paid after December 31, 1947 (Public Law 384, 80th Cong.).

2/ Exempted by order of the Secretary pursuant to authority of Section 307(c) of the Revenue Act of 1943, as amended. Federal Register, Volume 12, p. 4139.

Changes in tax rates since 1914

Revenue Act	Effective date	Rate
1914	Oct. 22	1¢ stamp tax on seats or berths in parlor cars, sleeping cars, etc.
1916	Sept. 9	Repealed
1917	Oct. 3	8% of charge for transportation a/ 10% of charge for seats and berths
1918	Feb. 24	8% of charge for transportation, seats and berths a/
1921	Jan. 1, 1922	Repealed
1941	Oct. 10	5% of charge for transportation, seats and berths b/
1942	Nov. 1	10% of charge c/
1943	Apr. 1, 1944	15% of charge d/

a/ No tax imposed on amounts paid for: commutation tickets for trips less than 30 miles, or transportation the fare for which does not exceed 35¢ under the Revenue Act of 1917 and 42¢ under the Revenue Act of 1918.

b/ No tax imposed on amounts paid for: transportation for which the charge does not exceed 35¢; commutation or season tickets for single trips of less than 30 miles; commutation tickets for one month or less; payments for round-trip tickets at tariffs of not more than 1-1/4¢ per mile by members of the armed forces of the United States in uniform and traveling at their own expense when on official leave.

c/ Exemption for special-rate furlough tickets extended to members of the armed forces of any of the United Nations.

d/ Section 8 of the Excise Tax Act of 1947, effective April 1, 1947, provided generally for exemption of travel outside the northern portion of the Western Hemisphere.

III. Revenue collections, 1942-1947

The yield from this tax is approximately the same as from the 3-percent tax on transportation of property. Annual collections are shown below:

Collections, fiscal years 1942-1947

(In millions)

Fiscal year	Collections
1942	$ 21.4
1943	87.1
1944	153.7
1945	234.2
1946	226.7
1947	244.0

IV. Economic background of the industry

A. Character of supply

Most of the taxable transportation service provided by rail, bus, air and water carriers consists of domestic intercity travel. However, prior to the war only about 15 percent of the intercity passenger miles was supplied by public transportation facilities subject to tax. (Table 1) The remaining 85 percent represented travel by private automobile. Of the total intercity travel by public transportation in 1941, railroads accounted for 64 percent, intercity buses for 29 percent, inland waterways for 4 percent, and airplanes for 3 percent. During the war passenger-car travel declined and travel by public carriers expanded. The largest in-increase occurred in railroad travel.

International transportation service is provided by steamship and airplane, but is relatively small compared with domestic intercity travel.

Table 1

Intercity passenger miles traveled in 1941, 1944, and 1945

Type of service	Passenger miles (In billions)			Percent of total		
	1941	1944	1945	1941	1944	1945
Private automobiles	264.3	151.3	179.8	84.8	54.0	58.8
Railroads	30.6	97.7	93.8	9.8	34.9	30.6
Intercity buses	13.6	26.5	26.8	4.4	9.5	8.8
Airplanes	1.4	2.3	3.5	.4	.8	1.1
Inland waterways	1.8	2.2	2.1	.6	.8	.7
Total	311.7	280.0	306.0	100.0	100.0	100.0

Treasury Department, Division of Tax Research

Source: Interstate Commerce Commission, Annual Report, 1943, 1946.

The passenger transportation industries are generally characterized by large fixed capital investment. Operations must usually be authorized by a governmental agency having jurisdiction and the rates of service are subject to regulation under the general principle of providing a fair return on the investment. The investment required by carriers varies widely with the type of service. Railroads require the largest investment in relation to volume of business since they must provide and maintain the roadway over which they operate and other expensive facilities. 1/ In 1945 total railroad investment in property and equipment was more than twice as large as operating revenues from freight and passenger service. (Table 2) Buses operate over the public highways; airway services are provided by the Federal Government while airports are generally municipally owned; Governmental agencies also maintain certain facilities for water carriers. Because of these basic factors there may be substantial differences in the flexibility of supply of the different services. Bus and air lines usually can begin or discontinue operations more readily than railroads. Transportation facilities, especially in the case of railroads, cannot readily be shifted to other uses. There is, however, considerable flexibility in the amount and kind of transportation service made available to the public under different conditions of demand. During the war, for example, the railroads handled an unprecedented volume of traffic without increasing passenger train equipment. 2/

There is competition both within and between the various types of taxed services. Each type of service has some distinctive advantages which affect its competitive position. Bus transportation offers the lowest priced service but ordinarily consumes more travel time. Railroad coach travel costs more but is usually faster than bus travel. Coach travel is competitive both with bus and Pullman travel. Pullman and air travel are also highly competitive. The advantage of air speed is more marked on the longer trips. Travelers

---

1/ Joint costs are an important factor in the railroad industry, since such facilities as roadways, terminals, and shops are used for both passenger and freight service. An important part of costs would not be reduced appreciably by reduction in passenger travel. Freight revenues normally constitute more than 80 percent of total revenues of railroads. Passenger buses and airlines carry little freight.

2/ Interstate Commerce Commission, Statistics of Railways in the United States.

Table 2

Ratio of operating revenues to investment in property and equipment, common carriers of freight and passengers, 1945

Carrier 1/	Investment in property and equipment 2/ Dec. 31, 1945	Operating revenues 1945	Ratio of operating revenues to investment
	(In millions)		
Railroads	$ 19,905.0	$ 8,902.2	.4
Water carriers	87.9	133.3	1.5
Motor carriers, passenger only	72.4	377.9	5.2
Airlines	171.3 3/	343.0 4/	2.0

Treasury Department, Division of Tax Research

Source: Railroads and water carriers, Interstate Commerce Commission, Statistics of Railways in the United States, 1945; motor carriers, unpublished data of Interstate Commerce Commission; airlines, Annual Report of the Civil Aeronautics Board, 1946.

1/ Covers Class I line-haul railroads; Class A and B water carriers; Class I intercity bus lines; domestic and international airlines.

2/ Represents net investment, after deduction for accrued depreciation and amortization. Railroad investment includes leased property and property of wholly-owned non-operating companies.

3/ As of June 30, 1946.

4/ Fiscal year ending June 30, 1946.

usually have the choice of using different types of service on longer trips and may also choose among two or more carriers furnishing the same type of service. In other cases a single carrier may have the exclusive right of providing service between certain points.

In the inter-war period the passenger business of the railroads as a whole became unprofitable. As traffic was lost to other forms of public transportation and to the private automobile, schedules were curtailed and equipment was reduced. The number of passenger train cars available declined sharply from 1927 to 1941. (Table 3) Between 1932 and 1941 only about 2,230 new cars were purchased by the Class I line-haul railways compared with 38,000 in service December 31, 1941. The curtailment of service and deterioration in equipment, in turn, resulted in further losses of potential traffic. There was a substantial decline in passenger miles prior to the depression years. As bus travel grew, the railroads in some cases acquired or developed bus lines to replace or supplement their own passenger service. However, this did not meet the problem created by loss of rail travel. At the outbreak of the war the capacity of available passenger equipment was greatly in excess of demand and enabled the railroads to carry a vastly expanded volume of traffic during the war. Without substantial change in equipment, revenue passenger miles increased from 21.7 billion in 1938 to 95.7 billion in 1944. (Table 3) In 1944 the average load per car was more than 2.5 times as high as in 1938 and twice as high as in 1921, when railroad passenger operations were still profitable. The number of car miles operated in 1944 was more than 50 percent above 1938. 1/ Some improvements have been made in train speeds and services, new equipment has been added and other equipment has been rebuilt and modernized. However, the cars were mainly acquired many years ago and there has been no substantial change in terminal or connection facilities for some time. Some increase in traffic appears to have been stimulated by rate reductions in the 1930's, but aside from this development the industry apparently did not succeed in improving its competitive position.

While railroad passenger travel declined, intercity bus travel expanded into a substantial industry. There is insufficient information to indicate in detail its growth and development, but the data available show that expansion continued well into the 1930's. It not only replaced railroad travel in certain areas but

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1/ Statistics of Railways in the United States, 1945, p. 52.

Table 3

Railroad and Pullman: passenger-train cars in service, new cars installed, passenger miles, and passenger miles per passenger-car mile, 1920 - 1945

Year	Number of passenger-train cars in service 1/: Total	Pullman	Other 2/	New cars installed 3/	Revenue passenger miles 4/ (billions)	Passenger miles per passenger car mile
1920	5/	5/	56,102	5/	47.4	5/
1925	65,560	8,746	56,814	5/	36.2	15
1929	63,289	9,451	53,838	5/	31.2	13
1930	63,364	9,780	53,584	5/	26.9	11
1931	61,558	9,462	52,096	5/	21.9	10
1932	59,856	9,258	50,598	58	17.0	10
1933	56,134	8,457	47,677	7	16.4	10
1934	53,336	8,452	44,884	270	18.1	11
1935	50,433	8,007	42,426	225	18.5	11
1936	49,388	7,998	41,390	159	22.5	13
1937	48,706	7,757	40,949	576	24.7	13
1938	47,509	7,578	39,931	275	21.7	12
1939	46,029	7,052	38,977	209	22.7	13
1940	45,218	6,910	38,308	154	23.8	13
1941	45,393	7,059	38,334	297	29.4	15
1942	45,580	7,134	38,446	273	53.7	22
1943	46,155	7,824	38,331	8	87.9	31
1944	46,968	8,751	38,217	104	95.7	32
1945	47,223	8,590	38,633	111	91.8	30

Treasury Department, Division of Tax Research

Source: Interstate Commerce Commission, Statistics of Railways in the United States.

1/ As of December 31.

2/ Includes baggage cars, postal cars and parlor and sleeping cars owned by the railroads.

3/ Class I line-haul railroads only; excludes cars owned and operated by the Pullman Company.

4/ Includes commutation.

5/ Not available.

also provided service in other areas not previously served by railroads. As indicated above, bus lines have more flexibility in the development of routes than the railroads and have been able to expand in the direction of increasing traffic potentials. Growth in the volume of business and the consolidation of operations have permitted improvement in facilities. Although such data as seating capacity and load factors are not reported, it is known that before the war buses had increased in size and improved substantially in speed and comfort. 1/ Production of buses of the intercity type amounted to approximately 11,500 (Table 4) in the 5 years 1936-1940 compared with 18,000 2/ reported in operation at the end of 1940. Ability of the bus industry to compete has been based largely on charging rates generally below the level of railroad fares and continued improvements in service and equipment. Apparently bus facilities were more fully utilized than railroad passenger equipment at the outbreak of the war. From 1940 to 1944 the number of bus passenger miles increased by only 97 percent compared with 206 percent for railroads, and during this period the number of intercity buses in operation expanded by 56 percent.

Because of the more recent development of air travel the equipment of airlines is more modern than that of competing services. The rapid expansion in operations from about 1937 reflected principally increases in the size of planes and in scheduled flights. Available seat miles tripled between 1937 and 1941, while the number of planes in operation increased by only 17 percent. (Table 5) The increased wartime traffic was handled largely by increases in the average load. The number of planes in the years 1942-43 was substantially below the 1941 level; the ratio of revenue passenger miles to available seat miles rose from 57 percent to 88 percent. Wartime developments in aviation have given further impetus to technological improvements, which strengthen the competitive position of the industry.

B. Rates

Prior to the war there was a downward trend in rates for all forms of passenger transportation. Basic railroad coach fares which were 3.6 cents per mile in 1920, were reduced in 1933 to 1.5 cents

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1/ Seating capacity of buses on the Greyhound lines increased from 29 to 41 between 1929 and 1939 ("Greyhound: Still Growing" Fortune, Dec. 1944).

2/ Statistical Abstract of the United States, 1941.

Table 4

Number of buses of intercity type produced, 1934 - 1946

Year	Number
1934	1,463
1935	2,255
1936	2,610
1937	2,430
1938	2,167
1939	2,415
1940	2,001
1941	2,088
1942	3,968
1943	1,691
1944	1,927
1945	3,508
1946	3,335

Treasury Department, Division of Tax Research

Source: Automobile Manufacturers Association, Automobile Facts and Figures, 1946 and 1947.

Table 5

Scheduled domestic and international airlines: number of planes, average seating capacity, passenger miles and available seat miles, fiscal years, 1937 - 1946

Fiscal year	Number of planes as of Dec. 31 1/	Average seating capacity 2/	Revenue passenger miles	Available seat miles	Revenue passenger miles, percent of available seat miles
			(In millions)		
1937	386	3/	457.8	849.1	53.9
1938	345	13.91	497.4	1,021.4	48.7
1939	339	14.66	621.2	1,170.4	53.1
1940	440	16.54	948.0	1,619.6	58.5
1941	453	17.54	1,313.0	2,315.3	56.7
1942	254	17.92	1,720.0	2,656.8	64.7
1943	273	18.34	1,682.9	2,061.9	81.6
1944	358	19.05	2,102.7	2,387.8	88.1
1945	518	19.68	3,087.9	3,540.8	87.2
1946	3/	3/	5,230.3	6,171.2	84.8

Treasury Department, Division of Tax Research

Source: U. S. Department of Commerce, Bureau of the Census, Statistical Abstract of the United States and Civil Aeronautics Board, Statistics of Airlines.

1/ In operation and reserve.
2/ Domestic air carriers only.
3/ Not available.

on southern railroads and 2.0 cents on western railroads, and in 1936 to 2.0 cents on the eastern roads. 1/ Certain increases made after 1936 were withdrawn or revoked prior to 1942. In 1942 the Interstate Commerce Commission granted the railroads a temporary increase of 10 percent, which was made permanent on December 6, 1946. A further increase averaging 10 percent was authorized on eastern roads June 1, 1947. 2/ On July 1, 1947 certain fare increases were made on western roads within the ceilings previously set by the Commission, and on December 8, 1947 the ceiling on first class fares was increased from 3.3 cents to 3.5 cents per mile. An increase averaging 13 percent on coach fares and 6 percent on certain first class traffic was authorized on southern roads October 8, 1947. Bus rates tend to follow the changes in coach fares being generally about 10 percent lower, but the relationship varies depending upon the region and local conditions. Domestic airline rates were reduced from 5.7 cents a mile in 1939 to about 4.5 cents in August 1945. In April 1947 rates were increased to approximately 5 cents per mile, and further increases approximating 10 percent have been proposed by most companies. 3/ The average passenger revenue on international air carriers was 8.7 cents per mile in 1946, approximately the same as in 1940. Effective October 1, 1947 charges for sleeping space on railroads were increased on some trips, the increases ranging up to 49 percent.

The regulation of rates and services in these industries has an important bearing on the adjustment that may be made in response to any reduction in travel caused by the tax. Adjustments in rates, in contrast to price changes in nonregulated industries, depend to a substantial extent on the action of the regulatory bodies. Generally, regulatory bodies have the power of approving or disapproving proposed changes in rates or can initiate a change. When the reduction in passenger fares on southern and western railroads produced increased net revenue, the Interstate Commerce Commission required eastern roads to lower their fares in 1936. In 1940 the Commission revoked an increase granted to eastern lines in 1938 on the grounds that the 1938 increase resulted in decreased net revenue. In 1942 the Commission took the position that increased fares would result in greater net revenue because automobile travel was being sharply curtailed. Apparently Federal regulation of passenger bus transportation is not as complete as railroad regulation. In the absence of protests, rates may be changed by the operating companies without approval of the Commission and competing lines are allowed to charge different rates between the same points. The competition among the various services is an important factor in the setting of rates. In the case of airlines, Government payments for carrying mail enter into the considerations involved in setting the charges for passenger service.

1/ Rates are fixed by classes of service. These figures represent approximations of one-way fare rates as given in rate discussions. See 237 Interstate Commerce Commission 271.

2/ On December 8, 1947, the New Haven Railroad was granted an additional 15 percent increase on coach fares.

3/ Some of the companies have published increased rates which, in the absence of disapproval by the Civil Aeronautics Board, become effective December 12. Others have sought permission to make increases effective on the same date. One company was granted an increase October 24, 1947.

C. Character of demand

The demand for transportation is composed of business requirements, urgent personal needs and optional personal travel. Information on the extent of business travel is limited. 1/ It appears that it represents a substantial proportion of total travel and a higher proportion of Pullman and possibly airline travel than coach and bus travel. Where travel expense is a small factor in the total costs of a business, the amount of travel is not likely to be affected substantially by a change in the charge for the service. The demand for personal travel will tend to vary with the urgency of the need. Because of the large element of pleasure travel, however, aggregate personal travel would tend to be more sensitive to price changes than business travel. The possible substitution of travel by automobile is a factor in the demand for the various forms of public transportation.

There is more evidence on the effect of price changes on railroad coach travel than on other forms of travel. After experimental rate reductions had indicated substantial increases in passenger travel, coach rates were reduced throughout the South from 3.6 cents per mile to 1.5 cents in 1933. When the southern railroads increased fares to 2 cents in 1937 total passenger revenues decreased and the rate of 1.5 cents was soon restored. 2/ Following the 1938 increase in rates on eastern roads the Interstate Commerce Commission concluded that net revenue was less than it would have been under the lower rate and ordered revocation of the increased rates. 3/ Studies by the Commission have indicated that on the basis of prewar experience decreases in rates within the ranges of the experience resulted in an increase in total revenue from coach travel. 4/

Less data are available on the responsiveness of Pullman travel to price changes. In 1936 the Interstate Commerce Commission took the position that highway competition had less effect on Pullman than on coach travel. 5/ The higher proportion of business travel and the higher income position of many who travel by Pullman on personal business probably make changes in fares of less importance

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1/ See p. 22 below.
2/ 237 Interstate Commerce Commission 273.
3/ 237 Interstate Commerce Commission 271.
4/ Interstate Commerce Commission, Statement No. 4129, "Preliminary Examination of Factors Affecting the Demand for Rail Passenger Travel," September 1941.
5/ 214 Interstate Commerce Commission 175. The Commission, however, eliminated the surcharge on sleeping and seating space.

than in the case of coach travel. Air travel may be even less sensitive to price changes. Price is an important factor in the case of bus travel, but there is no cheaper alternative form of public transportation as there is in the case of coach travel. This may tend to make bus travel less responsive to price changes than rail coach travel. It is likely that a general change in the cost of paid transportation has less effect on the total volume of travel than changes in relative costs would have on the volume of the different forms of travel. Normally, however, the total demand may be fairly responsive because of the possible alternative use of private automobiles. 1/

During the war the demand for public transportation increased greatly. Total revenue passenger miles rose from 47.4 billion in 1941 to 128.7 billion in 1944. (Table 1) The greatest increase both in absolute mileage and in relative proportion was registered by the railroads, which accounted for 76 percent of the total passenger miles in 1944, compared with 65 percent in 1941. Bus passenger miles doubled from 1941 to 1944, but decreased from 29 percent of the total in 1941 to 21 percent in 1944. Passenger miles on waterways and airlines also increased, but declined relative to the total. The wartime increases in bus and air transportation represented a continuation of the prewar growth in these services. In the case of rail travel, however, the wartime increases were in contrast to prewar developments and the number of passenger miles rose to a level more than twice the previous peak reached in 1920.

D. Outlook for the industry

Since the close of the war there has been a substantial decline in total intercity passenger travel on public transportation facilities, which has been accompanied by an increase in travel by passenger automobile. The shortage of new cars, however, has prevented automobile travel from expanding to the proportion of the total which it reached prior to the war. Passenger miles traveled on railroads declined by 30 percent from 1945 to 1946 and the railroad industry has estimated that revenue passenger miles will decline to about one-third of the peak wartime year by 1950. 2/

1/ A decrease in total cost would tend to result in some shifting to more expensive forms of travel. If this were substantial it might result in a relatively large increase in air travel.

2/ Association of American Railroads, Economic and Transportation Prospects, p. 164.

Bus travel was maintained at wartime levels in 1946 but the number of revenue passengers carried on intercity schedules decreased by 5 percent in the first half of 1947 compared with the first half of 1946. Airline travel has expanded greatly since the close of the war. (Table 5) These changes in general appear to be in line with the prewar trends.

The decline in passenger transportation since the close of the war is in large part attributable to the reduced needs of the Government. Government travel in general is exempt from the tax. Transportation charges subject to tax, as indicated by tax collections, have continued to hold at about the wartime peak level. (Table 6) Estimated consumer expenditures for intercity travel were maintained in 1946 at the 1945 level. (Table 7) During the war the ratio of such expenditures to disposable income 1/ nearly doubled. Between 1931 and 1941 there had been little change in this ratio, but in the latter year the ratio was substantially below the proportion of personal income spent for intercity travel in 1929 and 1930. A decline from the present high level may occur after the postwar adjustment has been completed and automobiles become readily available. There are no separate data on the trend of business travel which would indicate whether it is increasing or decreasing relative to personal travel.

Apparently the different forms of public transportation will be highly competitive in the future and each has undertaken improvements in equipment and service designed to strengthen its competitive position. The airlines apparently have on order about as many planes as are now in service, which would indicate substantial future expansion plans. 2/ Purchases of intercity buses in 1946 were about 50 percent above the years 1936-1939. (Table 4) The railroads have not yet made significant purchases of new passenger equipment, although the industry appears to feel that substantial modernization of coach travel will be necessary to meet bus and automobile competition and is reported to have on order

1/ Disposable income represents income payments less personal taxes. Department of Commerce data on income and expenditures used in this study, except where otherwise noted, are those issued prior to the revisions published in "National Income," Supplement to Survey of Current Business, July 1947.

2/ Civil Aeronautics Board, unpublished data.

Table 6

Collections from tax on transportation of persons, monthly,
1941 - 1947 1/

(In millions)

Month	1941	1942	1943	1944	1945	1946	1947
January		$ 3.2	$ 7.9	$ 10.6	$ 13.4	$ 19.3	$ 17.9
February		2.1	8.5	10.6	17.5	19.5	20.8
March		3.4	10.2	11.2	20.5	16.5	16.7
April		3.3	9.5	9.9	15.5	16.1	19.9
May		2.9	12.7	15.7 4/	20.3	21.0	17.1
June		3.8	8.2	14.3	17.3	15.3	17.2
July		4.6	13.6	21.4	20.1	20.4	25.8
August		4.3	14.2	21.6	23.6	24.3	20.9
September		4.7	14.8	22.4	16.6	23.7	25.3
October		5.3	15.0	22.8	24.0	27.9	25.1
November	.5 2/	4.1	12.0	19.9	18.0	17.1	
December	2.1	7.2 3/	11.9	21.6	16.8	20.9	
Total		48.9	138.5	202.0	223.6	242.0	

Treasury Department, Division of Tax Research

Source: Treasury Bulletin.

1/ Includes seats and berths.
2/ Tax of 5 percent effective October 10, 1941.
3/ Rate increased to 10 percent effective November 1, 1942.
4/ Rate increased to 15 percent effective April 1, 1944.

Table 7

Consumer expenditures for intercity travel
as a percentage of disposable income 1/
1929 - 1946

Year	Consumer expenditures for intercity travel (millions)	Disposable personal income (millions)	Expenditures percent of disposable income
1929	$ 521	$ 82,484	.6
1930	422	73,688	.6
1931	324	62,977	.5
1932	252	47,819	.5
1933	224	45,165	.5
1934	243	51,635	.5
1935	245	57,973	.4
1936	318	68,317	.5
1937	345	71,055	.5
1938	327	65,465	.5
1939	345	70,167	.5
1940	353	75,743	.5
1941	409	92,015	.4
1942	643	116,197	.6
1943	1,032	131,617	.8
1944	1,089	146,011	.7
1945	1,146	150,712	.8
1946	1,163	158,428	.7

Treasury Department, Division of Tax Research

Source: Supplement to Survey of Current Business, July 1947, pp. 19, 43.

1/ Expenditures include excise taxes. Data on disposable income and expenditures are from the July 1947 revised series.

about 2,500 passenger cars. 1/

The recent increases in passenger fares have been small in relation to changes in the general price level and in wage and material costs. Railroad passenger fares are only about 20 percent above the 1940 level compared with the increase of 60 percent in the Consumers' Price Index. (The increase in revenue per passenger-mile probably is smaller.) It has been estimated that railroad wage rates have increased by more than 70 percent while prices of materials and fuel have almost doubled since 1940. 2/ The railroad passenger business has reverted to the unprofitable position which existed for a number of years before the war.

Data on the profits of the bus lines are limited. The carriers reporting to the Interstate Commerce Commission showed some decrease in profits in 1946 and a much larger decrease during the early part of 1947. 3/ From the reported information it is not possible to determine how the present profit position of the industry compares with its prewar position. During the last quarter of 1946 and the first quarter of 1947 the airlines reported substantial losses on domestic operations. Following the rate increase in April 1947, the operations of domestic airlines as a whole showed a profit for the second quarter of 1947. 4/ Transportation companies operating in the coastal and foreign fields receive various types of Government assistance and the prospects of these concerns depend to a substantial extent on national policy with respect to the shipping industry.

1/ Association of American Railroads, unpublished data.
2/ Ibid.
3/ The number of reporting companies varies from period to period. For 1946 the net income before income taxes of intercity carriers was 27 percent less than in 1945 and for the first six months of 1947 was 56 percent less than for the same period in 1946. (Interstate Commerce Commission, "Statement No. Q-750(BRE)," 1946 and first two quarters of 1947.)
4/ The reported losses in the last quarter of 1946 and the first quarter of 1947 were \$11.0 million and \$19.4 million, respectively. Reported profits in the second quarter of 1947 were \$2.4 million. (Unpublished data of the Civil Aeronautics Board.)

V. Effects of the tax

A. On profits

The operation of passenger transportation facilities at capacity during the war resulted in increases in income for the industry. (Table 8) The railroads reported an excess of operating revenue over operating expenses on passenger operations for the first time since 1931. The improvement resulted primarily from the increased volume of traffic. Rail and bus rates were increased by only about 10 percent and airline rates actually decreased. In view of the large excess of demand for travel it is doubtful whether the existence of the tax had a significant effect on profits during the war period.

However, the abnormal wartime experience with the tax does not provide a basis for determining its effect on profits under peacetime conditions. When automobile demand becomes satisfied and other factors affecting demand and supply in the transportation industry have become adjusted to a peacetime basis, it is likely that the present tax would have a significant effect on the profits of the industry. There has, however, been no extensive peacetime experience with the tax which would indicate how responsive the total demand for transportation services may be to the changes in the cost of transportation. Business and the most urgent personal travel are probably not greatly affected by the increased cost represented by the tax. However, the possible substitution of automobile travel suggests that the volume of pleasure travel may be materially affected by the tax. The extent of reduction in travel on public facilities and the seriousness of its effects on profits may be substantially different for the several forms of transportation.

The prewar history of railroad rates indicates that coach travel is rather sensitive to changes in passenger fares. Accordingly, under normal conditions, the profits of railroads may be affected substantially by the existence of the tax. Because of large fixed costs a small decrease in passenger revenue can have an important effect on profits from passenger operations. Since railroads are again showing deficits on passenger operations, any reduction in traffic resulting from the tax would add to their difficulties. Bus travel may be somewhat less sensitive to increases in the cost of transportation and the possible continuation of an upward trend in this form of travel would tend to offset in part reduction in travel caused by the tax. Similarly, the favorable prospects for expansion of demand for air travel would help to offset the effects of the tax on the volume of traffic and profits. However, any reduction in passenger traffic of air lines tends to require larger payments by the Government for carrying air mail on some lines.

Table 8

Selected income data on intercity passenger transportation by railroads, buses and airlines, 1935 - 1945

Year	Railroads 1/			Buses 3/	Airlines 4/			
					Domestic		International	
	Net revenue from passenger operations (000,000)	Percentage ratio of expenses to revenue	Net operating income 2/ (000,000)	Net income before taxes (000,000)	Operating profit (000)	Percentage ratio of expenses to revenue	Operating profit (000)	Percentage ratio of expenses to revenue
1935	5/	129	5/	5/	$ - 3,299	114	5/	5/
1936	$ - 121.8	119	$ 233.3	5/	- 754	102	5/	5/
1937	- 131.9	120	241.6	5/	- 154	100	5/	5/
1938	- 133.2	122	255.3	5/	- 1,503	104	5/	5/
1939	- 132.6	121	250.9	23.6	1,399	97	5/	5/
1940	- 145.3	123	262.1	19.4	7,051	89	$ 4,954	79
1941	- 105.4	114	226.1	32.2	3,866	95	4,795	85
1942	300.6	78	89.3	83.4	14,287	87	9,082	79
1943	732.7	65	279.8	128.0	30,656	73	2,711	93
1944	721.0	68	234.1	130.0	26,729	80	2,143	94
1945	503.5	77	230.1	110.4	43,120	78	- 2,421	105

Treasury Department, Division of Tax Research

Source: Interstate Commerce Commission, Statistics of Railways in the United States, and Statistics of Class I Motor Carriers; Annual Report of the Civil Aeronautics Board, 1940-1946.

1/ Class I line-haul.
2/ Net revenue from passenger operations minus tax accruals plus rent income minus rents payable.
3/ Class I passenger carriers reporting to Interstate Commerce Commission. Not comparable from year to year because of different number of companies reporting.
4/ Scheduled lines reporting to Civil Aeronautics Administration. Includes mail, express and freight services. Figures are for fiscal years ending June 30.
5/ Not available.

The effect of the tax on profits of the transportation system is a matter of national concern because of its basic importance in the economy. Reductions in profits and consequent deterioration of service might require the Government to assume further responsibility in this area. In the case of airline and waterway traffic, for which benefits are now provided by the Government, decreased revenues resulting from the tax might necessitate larger Government expenditures in support of these services.

B. On business costs and competition

It appears that a substantial proportion of travel by public transportation is for business purposes, although information on this matter is limited. 1/ Information on the relative importance of travel costs in the operation of different types of business is not available. However, to the extent that there are differences in business use, the tax discriminates against those making most use of the service. Moreover, where competing businesses are located at different distances from the points to which their representatives must travel, the tax serves to increase the difference in expenditures for transportation service.

The tax also tends to create competitive inequities among the transportation agencies providing different types of service. Where the price charged for the service differs, the tax serves to increase the differential and thus tends to produce a shift in travel from

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1/ A representative of the industry has expressed the opinion that 50 percent of railroad travel is for business purposes. (House of Representatives, Hearings before the Committee on Ways and Means, Part 1, 80th Congress, first session, p. 165) A survey by the Works Progress Administration ("Survey of Passenger Travel for the Office of Defense Transportation, May 22-28, 1942," released June 11, 1942) indicated that about 50 percent of the persons interviewed were traveling for personal reasons. Department of Commerce estimates on consumers' expenditures in 1945 also indicate that at least half the total expenditures for intercity travel were for personal reasons. Since during the war years there was considerable travel by members of the armed forces and civilian employees of the Government, personal travel may normally account for substantially more than 50 percent of total transportation revenues. From 1945 to 1946, when total passenger revenues of carriers declined substantially, estimated consumer expenditures for intercity travel remained approximately the same. The data indicate that a lower proportion of Pullman travel than coach and bus travel is for personal reasons.

the higher priced to the lower priced service. 1/ However, as noted in Section IV C above, an increase in price may cause a relatively greater decrease in travel in the case of the lower fare service of railroad coaches and buses than in the case of Pullman and air travel, and this may more than offset any shift to the lower priced forms of transportation. The tax tends to discriminate against all transportation agencies operating for hire where private travel facilities may be used, as in the case of the automobile and airplane. As a result of the amendment effective April 1, 1947, generally exempting travel outside the northern portion of the Western Hemisphere, the tax discriminates to some extent against transportation companies and proprietors of resorts serving the area in which the tax is still applicable.

C. On consumers

Transportation expenditures are not large in relation to total consumer expenditures; the present tax increases the total Index of Consumer Prices by about .02 percent. The tax probably constitutes a higher proportion of income for the lower than the higher income groups. The tax on transportation expenditures made by business firms is likely to be reflected in prices paid by consumers in the long run, and thus be distributed regressively in accordance with consumer expenditures. On the basis of 1941 family income and expenditures, direct consumer expenditures for interurban transportation in the income class below $500 were about twice as large in relation to income as expenditures in the income classes between $500 and $5,000. 2/ A 1944 study of urban consumer expenditures alone indicated a relatively greater increase in expenditures for the income classes under $3,000 than for those between $3,000 and $5,000. 3/ This may reflect a relative increase in the movement of the working population during the war.

1/ If coach fare is $20 and bus fare $15 before tax, a 15 percent tax will make total costs $23 and $17.25, respectively. The tax increases the difference in costs from $5 to $5.75 or by 15 percent.

2/ Based on Bureau of Labor Statistics, Family Spending and Saving in Wartime, Bulletin No. 822, April 1945; Bureau of Agricultural Economics, Rural Family Spending and Saving in Wartime, Miscellaneous Publication No. 520, June 1943.

3/ Bureau of Labor Statistics, unpublished data.

The tax has the effect of withdrawing more purchasing power from the income stream during periods of high business activity than in periods of low business activity. During the period 1929-1940 expenditures for travel fluctuated substantially more than changes in disposable income. 1/

VI. Administration and compliance

This tax in general is not difficult to administer. It is collected for the Government by the transportation companies and it is estimated that only approximately 4,000 returns are filed. Some problems arise as to whether a vehicle is being operated on an established line, how the 35-cents-per-person exemption should be calculated for trips by groups, and the application of the tax to transportation not of the regular commercial type. The exemption of foreign travel has caused some difficulty in determining precisely what part of travel is tax exempt and what part is taxable.

VII. Technical problems

The principal technical problems that arise under this tax are:

1. The treatment of foreign travel.

2. The exemption of non-scheduled airflights carrying no more than 10 passengers including crew.

A. Treatment of foreign travel

Under the Revenue Act of 1943 the tax on transportation of persons applied to all tickets for which payment was made in the United States for travel within or without the United States. Section 8 (a) of the Excise Tax Act of 1947 amended the Internal Revenue Code to provide that "The tax shall not apply with respect to transportation any part of which is outside the northern portion of the Western Hemisphere...." The existence of the two areas results in discrimination against travel within the taxable area comprising generally the United States, Canada, Mexico and

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1/ Based on Department of Commerce data. On the average, a change of 1.3 percent transportation expenditures was associated with a change of 1 percent in disposable income.

Central America and favors travel to European, Asiatic, African and South American points. 1/ There are two types of discrimination, first, between domestic and certain types of foreign travel and second, between foreign travel to different areas. The second type of discrimination could be removed by further restricting the taxable area. Further restrictions, however, would raise increasingly difficult administrative problems. Under the present exemption most travel outside the taxable area is to points at some distance beyond the taxable zone. Limitation of the tax to travel in the continental United States would involve an allocation between the taxable and non-taxable fare in the case of the extensive travel to bordering countries and the Caribbean area. Moreover, since Canada also has a tax on transportation of persons there is the problem of having a uniform basis for the tax in both countries. If the tax is not made applicable to travel regardless of destination, it appears that there is no feasible way of preventing discrimination and avoiding administrative problems short of repeal.

B. The exemption of non-scheduled air flights

The present tax exempts transportation by motor vehicles having a passenger seating capacity of less than 10 adult passengers operating otherwise than on an established line. A similar exemption has been proposed in the case of air travel. However, travel of this character does not seem to be comparable to the exempted transportation by motor vehicles. In the latter case the exemption applies principally to transportation by taxicabs and is in line with the specific exemption provisions of the law which apply to amounts paid for transportation which do not exceed 35 cents, the amount paid for commutation or season tickets for single trips of less than 30 miles or commutation tickets for one month or less. These exemptions are based principally on administrative considerations, because transportation of this character involves a large number of transactions for short distances and comparatively small amounts, with the result that collection of the tax and the keeping of records would be very burdensome to the carriers. Non-scheduled air travel, on the other hand, does not present any particular administrative difficulties, and it is possible that the exemption of such travel might increase

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1/ Under the present limited facilities for foreign travel, the exemption has less tendency to stimulate shifts in travel than it would under less restricted travel conditions.

administrative problems because of the necessity for distinguishing between scheduled and non-scheduled trips. The exemption of non-scheduled air flights, moreover, would give rise to inequities and might stimulate avoidance of the tax and result in a substantial loss of revenue. The charter of airplanes for special trips generally involves the payment of substantial amounts for transportation services, and may represent the purchase of special conveniences in connection with transportation. The exemption would result in tax savings which would change the relative cost of scheduled and non-scheduled trips. 1/

1/ The tax on a party of eight persons traveling by scheduled airline between Washington and Chicago is approximately $72 at present rates. The tax on non-scheduled trips would depend upon the charge for such trips.

PART II - Excise Tax on Transportation of Property 1/

I. Description of the tax

The tax applies to amounts paid within the United States for the transportation of property from one point in the United States to another by rail, motor vehicle, water or air. Only amounts paid to a person engaged in the business of transporting property for hire are taxable. 2/ Shipments from a point without the United States to a point within the United States are taxable only on that part of the transportation which actually occurs in the United States and for which payment is made within the United States. The tax on the transportation of coal does not apply to the transportation of coal with respect to which there has been a previous taxable transportation.

The tax is payable by the person making the payment for the transportation, and is collected by the person receiving the payment.

Principal exemptions provided under the tax are:

1. Payments for transportation to and from State and local governments, an international organization, or the Red Cross.

2. Payments to the Post Office Department for transportation of property.

3. Payments for transportation of property to or from the United States Government shipped on a Government bill of lading. 3/

II. Changes in the tax since 1917

A tax on the transportation of property was levied under the Revenue Act of 1917. The tax rate and the effective date of changes since that Act are shown below:

1/ A separate excise tax levied on the transportation of oil by pipeline is not considered in this study.

2/ Including amounts paid to a freight forwarder, express company and similar persons, but not amounts paid by a freight forwarder, express company, or similar persons for transportation with respect to which a tax has previously been paid.

3/ Exempted by order of the Secretary pursuant to authority of Section 307(c) of the Revenue Act of 1943, as amended. Federal Register, Volume 12, p. 4139.

Changes in tax rates since 1917

Revenue Act	Effective date	Rate
1917	Nov. 1	3% of charge a/
1921	Jan. 1, 1922	Repealed
1942	Dec. 1	3% of charge b/

a/ On parcels or packages by express, 1 cent per 20 cents or fraction thereof.

b/ Tax on coal, 4 cents per short ton. Tax does not apply to transportation of coal with respect to which there has been a previous taxable transportation.

III. Revenue collections, 1943 - 1947

Collections from this tax are approximately the same as from the 15 percent on transportation of persons. Annual collections are shown below:

Collections, fiscal years 1943 - 1947

(In millions)

Fiscal year	Collections	Fiscal year	Collections
1943	$ 82.6	1946	$ 220.1
1944	215.5	1947	275.7
1945	221.1		

IV. Economic background of the industry

The effects of the tax on transportation of property which appear to be most significant are those that arise from its impact on the cost structure of the economy, the competitive position of the different users of transportation service and the choice of different methods of transportation. 1/ Some understanding of the general supply and demand characteristics of the industry, however, is essential to analysis of these effects as well as of the direct effects of the present tax on the volume of business and profits of the transportation industry.

The industries engaged in the transportation of property account for a larger proportion of the national income than most other industries. In 1946 the income originating from transportation of property was larger than the total originating from mining, communications, public utilities or construction. 2/

A. Character of supply

Carriers of property may be grouped into two broad classes — intracity and intercity. The volume of intracity traffic is not known, 3/ but it appears that the bulk of taxable transportation is of the intercity type. The volume of intercity freight transportation increased from about 500 billion ton-miles before the war to nearly 1,000 billion ton-miles in 1944. (Table 1) The railroads transported nearly 80 percent of the total in 1943 compared with a little over two-thirds prior to the war. They probably carry a higher proportion of taxable intercity shipments, however, since a substantial part of both motor and water shipments is carried in equipment owned or rented by the shipper and is not taxable under the present law. The inland water carriers before the war handled nearly twice as much traffic as motor carriers. 4/ The amount moved by airlines is relatively small.

The industries transporting property for hire are generally subject to Federal or State regulation. At present Federal agencies regulate about 23,000 operating freight-carrying concerns, of which approximately 21,000 are motor carriers. 5/ Most of the revenue

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1/ These questions are considered in Section V, below.

2/ "National Income," Supplement to Survey of Current Business, July 1947.

3/ In 1935, the latest year for which complete data are available, approximately 50,000 firms owning about 100,000 trucks were engaged in the business of local transportation of property for hire. (Census of Business: 1935, "Motor Trucking for Hire.") In addition, a large number of trucks was owned by shippers.

4/ Data on ton-miles are not available for coastwise shipping, but prior to the war coastwise vessels accounted for about 20 percent of the total cargo carried by domestic water carriers. Statistical Abstract, 1940.

5/ Unpublished data of the Interstate Commerce Commission. The number of companies subject to State regulation is not known. Apparently all States regulate the weight and size of motor carriers and most of them regulate intrastate rates.

Table 1

Estimated volume of intercity traffic of freight, public and private, by kinds of transportation, 1937-1945 1/

Year	Total	Railroads 2/	Motor carriers	Inland waterways	Airway 3/
	1. Volume of traffic (In billions of ton-miles)				
1937	517.75	363.61	44.00	110.13	.009
1938	396.27	292.51	37.00	66.75	.010
1939	475.36	336.10	43.00	96.25	.011
1940	548.23	379.16	51.00	118.06	.014
1941	679.34	481.75	57.12	140.45	.016
1942	844.07	645.26	50.21	148.57	.033
1943	924.62	734.72	48.20	141.65	.052
1944	946.66	747.17	49.31	150.11	.071
1945	889.45	690.99	55.62	142.76	.091
1946- P	791.40	602.20	66.00	123.10	.100
	2. Percentage distribution				
1937	100.0 %	70.2 %	8.5 %	21.3 %	4/
1938	100.0	73.8	9.3	16.8	4/
1939	100.0	70.7	9.0	20.2	4/
1940	100.0	69.2	9.3	21.5	4/
1941	100.0	70.9	8.4	20.7	4/
1942	100.0	76.4	5.9	17.6	4/
1943	100.0	79.5	5.2	15.3	4/
1944	100.0	78.9	5.2	15.9	4/
1945	100.0	77.7	6.3	16.1	4/
1946- P	100.0	76.1	8.3	15.6	4/

Treasury Department, Division of Tax Research

Source: Interstate Commerce Commission, Annual Report, 1937 through 1945.

1/ Excludes pipe-line transportation and coastal shipping.
2/ Steam and electric railways. Includes express and mail.
3/ Domestic revenue service. Includes express and mail.
4/ Less than 0.05 percent.
P - Preliminary.

freight, however, is carried by the less than 1,000 railroad companies. The fixed investment in these industries is very large. Equipment and facilities cannot readily be shifted to alternative uses, partiaularly in the case of railroads where the investment in roadway is very substantial and the equipment very durable. The amount of service rendered, however, can be varied substantially in response to changes in demand by altering schedules, speed of travel, and the number of units placed in service.

There is considerable competition among the various types of carriers, but it is limited by considerations of speed, cost, and suitability for particular shipping problems. Water carriers, which operate only in certain areas, and the railroads provide low-cost transportation for bulky shipments. Motor carriers are more generally confined to handling goods having a high value per pound in intercity transportation but perform all types of local hauling. Most airline cargo consists of high priced goods or expedite shipments.

Although railroad freight traffic has declined relative to total intercity shipments, 1/ unlike passenger traffic, the absolute amount continued to increase during the 1920's. At the outset of the war the ton-miles carried by railroads was nearly as large as the peak traffic of the 1920's. Moreover, the competitive position of the railroads has been strengthened by improvements in facilities and service. Substantially less equipment is now required in relation to the volume of traffic (Table 2) and increased efficiency has been reflected in other aspects of operations. 2/ Less information is available on the trucking industry, but total truck production in the latter part of the 1930's reached a higher average than in the years preceding the depression. 3/ There was also some growth in the capacity of water carriers. 4/ The future role of air freight transportation has received increasing attention since the close of the war and involves considerations of public policy which have not as yet been resolved.

1/ Wald, Haskel P., "War Strengthened Railroads Face New Prospects," Part II, Survey of Current Business, December 1945.

2/ For example, tractive effort (pulling power) of freight locomotives increased by about 60 percent between 1921 and 1941. (Interstate Commerce Commission, Statistics of Railways in the United States, 1929, 1945).

3/ Automobile Manufacturers Association, Automobile Facts and Figures, 27th Edition, 1946 and 1947.

4/ In 1930 the total number of ships engaged in coastwise and internal trade was 21,025 with a combined tonnage (gross registered tons) of 9.8 million; in 1941 the figures rose to 25,636 and 11.1 million, respectively. (Statistical Abstract.)

Table 2

Railroads: Number of freight-carrying cars owned or leased, average capacity, new cars installed, revenue ton-miles and ton-miles per car-mile, 1921 - 1945 1/

Year	Freight-carrying cars, owned or leased 2/: Number (thousands)	Freight-carrying cars, owned or leased 2/: Average capacity (tons)	New cars installed	Revenue ton-miles (billions)	Average number of ton-miles per car-mile (loaded movement)
1921	2,316	42.5	3/	306.8	27.3
1925	2,357	44.8	3/	413.8	26.9
1929	2,277	46.3	3/	447.3	26.9
1930	2,277	46.6	3/	383.4	26.5
1931	2,201	47.0	3/	309.2	25.6
1932	2,145	47.0	2,815	234.0	24.7
1933	2,035	47.5	1,936	249.2	25.4
1934	1,938	48.0	23,948	268.7	25.5
1935	1,836	48.3	6,987	282.0	25.8
1936	1,758	48.8	37,554	339.2	26.8
1937	1,744	49.2	69,118	360.6	27.1
1938	1,700	49.4	15,213	290.1	26.0
1939	1,650	49.7	23,236	333.4	26.9
1940	1,654	50.0	60,455	373.3	27.6
1941	1,703	50.3	76,392	475.1	28.4
1942	1,745	50.5	58,595	638.0	31.8
1943	1,756	50.7	28,000	727.1	33.3
1944	1,770	50.8	38,970	737.2	32.6
1945	1,760	51.1	37,132	681.0	32.2

Treasury Department, Division of Tax Research

Source: Interstate Commerce Commission, Statistics of Railways in the United States, 1929, 1939 and 1945

1/ Class I line-haul railways. Excludes private freight-carrying cars, which decreased from 296,000 at the end of 1935 to 268,000 at the end of 1945.

2/ As of December 31.

3/ Not available.

B. Rates and costs

The freight rate structure is very complex. Rates vary according to region, zone, class, commodity, weight, bulk, value, and direction of movement. In the case of railroads five major rate territories are recognized, some of which are further subdivided into zones, and within each territory and zone there are a large number of class rates. These vary widely by regions and there are numerous exceptions to class rates. 1/ About 80 percent of freight traffic moves on commodity rates and is fairly independent of either rate territory or freight classification. The report of the Board of Investigation and Research commented as follows on the lack of uniformity in rate structure.

> Such differences grow out of different conditions existing within the various territories, and differences in the views of rate-making officials concerning a reasonable and proper rate structure. Each rate structure is the product of the policies of rate-making officials of the railroads, with whom initiative in rate making rests modified by the pressures of shipper groups seeking rates which would be advantageous to their interests, and modified further by the policies of State and Federal regulatory authorities. 2/

Motor carrier rates average higher than rail freight rates, while water rates are generally lower. However, considerable study is usually required to determine the most economical carrier for any particular shipment because the type of carrier whose charge is generally higher may furnish the cheapest transportation in some cases.

There have been few general changes in railroad rates during the past 30 years and the most important have been associated with wartime changes in the economy. The general level of rates in effect at the outset of World War II did not differ much from that established in 1920. A temporary increase of 4.7 percent granted in March 1942 was suspended in May 1943 because of increased profits. The first permanent

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1/ House of Representatives, Summary Report on Study of Interterritorial Freight Rates, House Document No. 145, 78th Congress, 1st Session, March 3, 1943, p. 2. Class I rates in zone IV of the western trunk-line territory were 84 percent above those in the eastern territory in 1938.

2/ Ibid, p. 3.

increase over prewar rates, averaging about 18 percent was granted in December 1946, superseding an interim increase of 6 percent granted in June of that year. Rising costs have resulted in a further request for increase in rates. As amended, the increase requested would average about 30 percent. An interim increase averaging about 9 percent was granted October 7, 1947, pending further consideration of the request for a permanent increase. Although there have been exceptions, railroad rate adjustments have generally been accompanied by corresponding changes in motor and water carrier rates.

C. Character of demand

The demand for transportation service arises principally from business requirements and varies with the type of commodity transported. Since transportation costs generally are small in relation to the total costs of business, it would appear that the use of transportation would depend more upon changes in other costs than in the price of transportation.1/ Important exceptions exist where transportation constitutes a large percentage of total cost of a product. 2/ There is no evidence that the aggregate demand for transportation service is very responsive to changes in rates. 3/ An increase in rates tends to limit the market area. 4/ However, where a rate increase may force one shipper out of a market the loss of this business will tend to be offset in substantial part by increased business from other shippers. A more important effect of a rate increase on public transportation may be the possible loss in traffic to privately owned carriers and shifts from one type of carrier to another. Direct consumer use of facilities subject to the tax on transportation of property represents a small proportion of the total and the demand probably is determined more by other factors, such as the necessity for moving, than by the cost of the transportation.

1/ It has been estimated that in 1929 transportation expenses represented 13 percent of total manufacturers' cost of preparing and distributing finished commodities. (The Twentieth Century Fund, Inc., Does Distribution Cost Too Much?. 1939, pp. 117-118.)

2/ Section V, below.

3/ There has been no indication that the average increase of 18 percent made in December, 1946 materially affected the volume of traffic. Conditions, however, have been abnormal because of the shortage of facilities. In the rate discussions of the Interstate Commerce Commission less consideration appears to have been given to the effect of rate changes on demand in the case of freight transportation than passenger transportation.

4/ "Tentative Report of the Committee of the National Tax Association on Taxation of Transportation," National Tax Association. Proceedings of the Thirty-ninth National Conference on Taxation, 1946.

D. Outlook for the industry

For the near future the volume of freight transportation is expected to tax available facilities. The railroads experienced some decline in volume and in revenues in 1946. During the first 9 months of 1947 the volume has exceeded that for the same period in 1946 by a substantial margin while revenues have increased relatively more due to rate increases. (Table 3) Operating revenues of both motor and water carriers reporting to the Interstate Commerce Commission increased in 1946. 1/ Despite the large volume of traffic and higher rates, profits have been adversely affected by rising costs and additional rate increases have been requested by the railroads. Until the postwar transition has progressed farther, it is difficult to secure an indication of the shifts that may take place in the traffic of different carriers. Both motor and rail carriers report inability to secure equipment to meet current demands. 2/

V. Effects of the tax

A. On profits of the transportation industry

For most of the period since this tax was imposed the transportation industries have operated at or near capacity and during the war income was much higher than the prewar level. (Table 4) Railroad profits were particularly favorable and the temporary rate increase in 1942 was rescinded because of the large increase in profits. Because of supply limitations it is doubtful whether the tax has had a significant effect on carrier profits. Under more normal conditions the tax would probably have some effect on the volume of traffic and profits. Because of high fixed costs a reduction in the volume of traffic has a proportionately greater effect on profits. However, in view of the probable unresponsiveness of the demand for freight transportation to changes in the cost of such transportation and the relatively low rate of the present tax, it is doubtful whether the profits of the industry would be affected very substantially by the tax.

1/ Revenues of motor carriers increased from $740.5 million in 1945 to $871.1 million in 1946, while revenues of water carriers rose from $64.8 million in 1945 to $90.8 million in 1946. (Interstate Commerce Commission, "Statement No. Q-500," Year 1946, and "Statement No. Q-650," Year 1946.)

2/ About one-third of railroad freight cars are more than 25 years old. Murphy, Thomas J., "Need for Freight Cars is Becoming More Urgent," Domestic Commerce, July 1947.

Table 3

Railroad freight revenues and revenue ton-miles of freight carried, by months, 1945 - 1947 1/

Month	1945	1946	1947
	1. Freight revenue (In millions)		
January	$ 558.7	$ 453.6	$ 551.3
February	536.7	421.5	518.9
March	623.1	484.0	592.5
April	594.2	412.0	565.1
May	626.2	399.4	592.0
June	610.9	458.6	557.2
July	589.4	513.4	558.2
August	547.5	546.3	596.9
September	488.5	515.8	593.2
October	492.5	567.2	
November	463.9	523.0	
December	401.4	494.1	
Total	6,533.1	5,789.3	
	2. Revenue ton-miles (In billions)		
January	56.8	48.2	53.3
February	55.4	45.1	48.5
March	64.4	52.4	56.1
April	61.4	37.4	50.7
May	64.2	39.5	56.1
June	62.5	49.8	53.4
July	60.7	51.9	51.0
August	56.8	55.8	58.0
September	52.7	52.9	56.1
October	49.8	57.4	
November	49.8	51.9	
December	46.3	49.6	
Total	680.7	592.0	

Treasury Department, Division of Tax Research

Source: Interstate Commerce Commission, "Statement M-220".

1/ Class I line-haul railroads.

Table 4

Selected income data on transportation of property by railroads, motor and water carriers, 1937 - 1945 1/

(In millions)

Year	Net revenues from freight operations of railroads (Class I)	Net operating revenue of motor carriers 2/ (Class I)	Net income before taxes of water carriers 3/
1937	$ 1,173.4	4/	$ 66.6
1938	973.9	$ 8.7	39.5
1939	1,206.9	20.7	58.1
1940	1,350.1	21.5	108.6
1941	1,785.9	31.3	172.1
1942	2,562.4	40.9	145.9
1943	2,663.6	30.8	113.5
1944	2,431.6	24.7	4/
1945	1,345.1	7.2	4/

Treasury Department, Division of Tax Research

Sources: Railroads and motor carriers, Interstate Commerce Commission, Statistics of Railways in the United States, Annual Report of the Interstate Commerce Commission. Water carriers, Bureau of Internal Revenue, Statistics of Income, Part 2.

1/ Excludes net income from freight operations of airlines, for which no data are available. Freight revenue constitutes a small proportion of total airline income.

2/ Not comparable from year to year because of changes in the number of companies reporting to the Interstate Commerce Commission.

3/ Includes income from passenger operations. In 1945 passenger revenue constituted 12 percent of total revenue of carriers reporting to the Interstate Commerce Commission (Interstate Commerce Commission, Statistics of Railways in the United States, 1945, Table 174).

4/ Not available.

B. On business costs and competition

1. Business costs

The tax tends to increase business costs generally but not uniformly. Moreover, since it applies to shipments of raw materials as well as finished goods there is considerable opportunity for pyramiding of the tax, as goods flow through the various stages of production and distribution. The varied effects can be considered under two headings: (a) general effects on the cost structure of the economy, (b) effect on competition among different users.

a. Effects on cost structure of economy

Transportation represents an important basic cost in the economy. Because of the inflexibility of freight rates, adjustments in cost-price relationships are impeded when economic conditions change. A tax on such a rigid cost factor increases the inflexibility of total costs. Since the impact of the tax is very unequal on different segments of the economy it tends to stimulate changes which interfere with a balanced expansion of production and employment. The tax has relatively little direct impact on the finance and service industries. But by raising transportation costs it tends to raise the price and discourage the use of physical plant and equipment compared with the use of labor. Since it tends to limit the market area for a commodity the tax retards the exploitation of resources and may stimulate uneconomical re-location of industry. Shifts in industry location require considerable time and may not take place if the tax is viewed as a temporary measure. However, where the tax causes a shift the uneconomical location of the plant will persist even if the tax is later removed.

b. Competition among different users

The tax introduces competitive problems between producers of the same commodity selling in a common market since it increases the freight differential against the producers having the highest rate. For example, if one producer, because of distance or other factors, has a $5.00 freight rate while another has a $10.00 rate, the 3 percent tax will raise the differential in shipping charges from \$5.00 to \$5.15. Although the tax rate is relatively low, a large volume of total freight is in the form of raw materials where small differences in costs may determine the source of supply to be used. 1/ Transportation costs vary widely in relation to the value of products shipped. They amount to more than half the value of the products at destination in the case of such heavy commodities as gravel, sand and salt, some fresh fruits and certain forest products. The principal products on which transportation costs were relatively most important in 1941, the latest year available, are shown in Table 5. Since that year there have been substantial changes in rates and in the value of products. The ratio is high for most fresh fruits and vegetables because of the special handling required. Even where the ratio is lower for a raw material, numerous shipments during the process of conversion to a finished product may increase the ratio of transportation to total costs. In such cases as steel products, for example, the tax operates in much the same way as a turnover tax and is subject to some of the objections usually raised to this form of tax. A self-contained industry which has its own transportation facilities and is not required to pay the tax because it is a private carrier is placed in an advantageous position compared with competitors that must use public transportation. A mine which must ship its ore by public transportation is placed at a disadvantage compared with one which can process the ore before shipment.

The competitive effects will be very uneven for business because of the wide variations in the importance of transportation costs by industries and in the location of different firms selling in a common market. The ability of shippers to raise their prices by the amount of the tax will also vary with the supply and demand conditions for their products. If the demand is very unresponsive, the most distant shippers may not have to absorb much of the tax and more favorably located shippers would tend to receive a windfall. However, even where the tax causes a

1/ The importance of variations in distance between producing areas and their common markets has been recognized as a factor in railroad rate adjustments. "Thus, in 1933 and 1936, when substantial reductions were made in rates on citrus fruit, the same reduction was applied from California, Arizona and Florida, to preserve the existing competitive situation by continuing the existing spreads." (266 Interstate Commerce Commission, 537, 564)

Table 5

Freight revenue and tax on transportation of property in relation to value at destination for selected commodities in railroad car lots, on the basis of freight revenues and values in 1941 1/

Group	Commodity	Percent freight revenue of value at destination	Effective rate of tax on value of commodity
	All commodities, total	6.0 % 2/	.18 % 2/
I.	Products of agriculture, total	10.25	.31
	Grapes, fresh	52.49	1.57
	Oranges and grapefruit	40.06	1.20
	Vegetables, fresh	39.13	1.17
	Potatoes, other than sweet	32.48	.97
	Apples, fresh	25.43	.76
	Bananas	18.61	.56
	Barley and Rye	15.15	.45
	Oats	13.26	.40
	Corn	12.85	.39
	Wheat	10.40	.31
II.	Animals and products, total	3.71	.11
	Fresh meats	4.69	.14
	Cattle and calves, single deck	4.10	.12
	Hogs, double deck	4.01	.12
	Meats, cured, dried or smoked	3.93	.12
	Packing-house products, n.o.s.	3.79	.11
III.	Products of mines, total	29.12 2/	.87 2/
	Salt	60.97	1.83
	Gravel and sand	50.25	1.51
	Stone, broken, ground or crushed	45.95	1.38
	Asphalt	35.59	1.07
	Bituminous coal	50.94	.92 3/
IV.	Products of forests, total	12.65	.38
	Posts, poles and piling	64.06	1.92
	Pulp wood	35.04	1.05
	Lumber, shingles and lath	18.59	.56
	Veneer and built-up wood	16.00	.48
	Box, crate and cooperage materials	14.21	.43

(Continued on next page)

Table 5
(concluded)

Group	Commodity	Percent freight revenue of value at destination	Effective rate of tax on value of commodity
V.	Manufactures and miscellaneous, total	4.66	.14
	Cement, natural and Portland	26.67	.80
	Fuel, road and petroleum residual oils	22.06	.66
	Petroleum oils	17.88	.54
	Paperboard, pulpboard and wallboard	13.17	.40
	Brick, n.o.s. and building tile	13.07	.39
	Scrap iron and scrap steel	11.99	.36
	Lubricating oils and greases	11.77	.35
	Glass: bottles, jars and jelly glasses	11.48	.34
	Cast-iron pipe and fittings	11.26	.34
	Fertilizers, n.o.s.	10.98	.33
	Newsprint paper	10.50	.32
	Iron-pig	9.97	.30
	Iron and steel - nails and wire, not woven	9.75	.29
	Building paper and prepared roofing materials	9.01	.27
	Iron and steel, rated 5th class	8.28	.25
	Iron and steel pipe and fittings	8.23	.25
	Sugar (beet or cane)	6.45	.19
	Explosives, n.o.s.	6.31	.19
	Automobiles, passenger	5.75	.17
	Iron and steel, rated 6th class	5.36	.16
	Canned food products	5.17	.16
	Furniture, other than metal	5.11	.15

Treasury Department, Division of Tax Research
Source: Interstate Commerce Commission, Freight Revenue and Value of Commodities Transported on Class I Steam Railways in the United States, Calendar Year 1941; Statement No. 4329.

1/ Items selected represent the most important items in each group, in terms of freight revenue paid, for which the effective rate of the tax is higher than for the group as a whole.
2/ Excluding coal, which is taxed on the basis of weight.
3/ Computed on the basis of tax of 4¢ per ton and a value of $4.35 per ton at destination.

shipper to drop out of the market, prices to the buyers of the product will tend to be increased where the new supply, although it may be closer to the market, is produced under higher cost conditions. Differences in industry practices in pricing for transportation will also affect price adjustments. Where products are shipped f.o.b. prices to buyers would tend to reflect the tax at once, but where shippers pay the freight a change in prices charged by them would be necessary to reflect the tax. 1/

2. Competition in the transportation industry

The tax increases the differences in rates charged by different carriers. While some shippers, such as those of heavy, bulky commodities, may have no choice of forms of transportation, others may ship by several different methods. If there is a significant difference in rates between carriers, the tax will widen the difference in favor of the lower priced carriers. Generally water and railroad freight rates are lower than truck and express rates.

The competitive position of carriers is also affected by the fact that the tax is not applicable to certain types of shipments. Since transportation by private carriers is not taxable, some inducement is offered producers to expand their own shipping facilities up to the point where such private transportation about equals the cost of taxed public transportation. Motor and air carriers are likely to be most affected by this type of competition for while producers can acquire trucks or planes they cannot readily build railways or waterways.

C. Effect on consumers

This tax appears to have a very regressive effect. Although the tax falls largely on business costs, business will endeavor to pass it on to consumers. As indicated in the preceding section, the extent to which the tax is passed on to them by business users will differ from industry to industry. It would appear that the tax is more likely to be passed on to consumers in the case of basic items of consumption for which the demand tends to be more unresponsive to price increases. Moreover, the tax probably tends to increase the price of goods more than services. Because consumers in the lower income groups spend a higher proportion of their income for goods than services, the tax passed on to consumers is probably more regressive than total consumer expenditures. In addition, pyramiding of the tax is more likely than in the case of a tax levied directly on consumer expenditures.

1/ Different types of geographic price structure are discussed in Temporary National Economic Committee, Monograph No. 1, "Price Behavior and Business Policy," Washington 1940, pp. 273, et seq.

Various price indexes will be increased by the tax but because of its indirect effects it is difficult to estimate the extent of change involved.

VI. Administration and compliance

It appears that there are approximately 85,000 carriers filing returns under the tax. Variations in the services rendered by different carriers create some special problems. The most difficult questions arise in the treatment of related or "accessorial" services such as the feeding of stock and icing of refrigerator cars. Difficult questions also arise as to whether a firm is engaged in the business of transporting property for hire. The determination of whether a shipment is an export shipment, and thus exempt from tax, entails additional work for both shippers and the Bureau of Internal Revenue. The necessity for securing exemption certificates also imposes a substantial burden on shippers.

VII. Technical problems

Most of the problems which give rise to inequities and to difficulties in administration and compliance appear to be inherent in the imposition of a tax on the transportation of property. Basic changes in the tax designed to meet these problems would either give rise to other inequities or increase administrative problems excessively. The present form of tax in its technical aspects is about as satisfactory as can be devised.

TREASURY DEPARTMENT

Washington

FOR RELEASE, MORNING NEWSPAPERS,
Tuesday, December 16, 1947.

Press Service
No. S-568

The Secretary of the Treasury announced last evening that the tenders for $1,300,000,000, or thereabouts, of 91-day Treasury bills to be dated December 18, 1947, and to mature March 18, 1948, which were offered December 12, 1947, were opened at the Federal Reserve Banks on December 15.

The details of this issue are as follows:

Total applied for - $1,759,239,000
Total accepted - 1,301,989,000 (includes $38,126,000 entered on a non-competitive basis and accepted in full at the average price shown below)

Average price - 99.760 Equiv. rate of discount approx. 0.949% per annum

Range of accepted competitive bids:

High - 99.790 Equiv. rate of discount approx. 0.831% per annum
Low - 99.759 " " " " " 0.953% " "

(45 percent of the amount bid for at the low price was accepted)

Federal Reserve District	Total Applied for	Total Accepted
Boston	$ 1,513,000	$ 1,472,000
New York	1,608,804,000	1,188,336,000
Philadelphia	1,615,000	1,615,000
Cleveland	5,875,000	5,435,000
Richmond	4,407,000	4,407,000
Atlanta	2,250,000	2,250,000
Chicago	69,279,000	35,618,000
St. Louis	3,615,000	3,615,000
Minneapolis	2,820,000	2,820,000
Kansas City	14,235,000	14,235,000
Dallas	17,369,000	17,104,000
San Francisco	27,457,000	25,082,000
TOTAL	$1,759,239,000	$1,301,989,000

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TREASURY DEPARTMENT
Washington

FOR RELEASE, MORNING NEWSPAPERS,
Friday, December 19, 1947.

Press Service
No. S-569

Secretary of the Treasury Snyder today announced the offering, through the Federal Reserve Banks, of 1-1/8 percent Treasury Certificates of Indebtedness of Series A-1949, open on an exchange basis, par for par, to holders of Treasury Certificates of Indebtedness of Series A-1948, in the amount of $3,134,197,000, which will mature on January 1, 1948. Cash subscriptions will not be received.

The certificates now offered will be dated January 1, 1948, and will bear interest from that date at the rate of one and one-eighth percent per annum, payable with the principal at maturity on January 1, 1949. They will be issued in bearer form only, in denominations of $1,000, $5,000, $10,000, $100,000 and $1,000,000.

Pursuant to the provisions of the Public Debt Act of 1941, as amended, interest upon the certificates now offered shall not have any exemption, as such, under the Internal Revenue Code, or laws amendatory or supplementary thereto. The full provisions relating to taxability are set forth in the official circular released today.

Subscriptions will be received at the Federal Reserve Banks and Branches, and at the Treasury Department, Washington, and should be accompanied by a like face amount of the maturing certificates. Subject to the usual reservations, all subscriptions will be allotted in full.

The subscription books will close for the receipt of all subscriptions at the close of business Tuesday, December 23.

Subscriptions addressed to a Federal Reserve Bank or Branch or to the Treasury Department, and placed in the mail before midnight December 23, will be considered as having been entered before the close of the subscription books.

The text of the official circular follows:

UNITED STATES OF AMERICA

1-1/8 PERCENT TREASURY CERTIFICATES OF INDEBTEDNESS OF SERIES A-1949

Dated and bearing interest from January 1, 1948 Due January 1, 1949

1947
Department Circular No. 821

Fiscal Service
Bureau of the Public Debt

TREASURY DEPARTMENT,
Office of the Secretary,
Washington, December 19, 1947.

I. OFFERING OF CERTIFICATES

1. The Secretary of the Treasury, pursuant to the authority of the Second Liberty Bond Act, as amended, invites subscriptions, at par, from the people of the United States, for certificates of indebtedness of the United States, designated 1-1/8 percent Treasury Certificates of Indebtedness of Series A-1949, in exchange for Treasury Certificates of Indebtedness of Series A-1948, maturing January 1, 1948.

II. DESCRIPTION OF CERTIFICATES

1. The certificates will be dated January 1, 1948, and will bear interest from that date at the rate of 1-1/8 percent per annum, payable with the principal at maturity on January 1, 1949. They will not be subject to call for redemption prior to maturity.

2. The income derived from the certificates shall be subject to all taxes now or hereafter imposed under the Internal Revenue Code, or laws amendatory or supplementary thereto. The certificates shall be subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but shall be exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority.

3. The certificates will be acceptable to secure deposits of public moneys. They will not be acceptable in payment of taxes.

4. Bearer certificates will be issued in denominations of $1,000, $5,000, $10,000, $100,000 and $1,000,000. The certificates will not be issued in registered form.

5. The certificates will be subject to the general regulations of the Treasury Department, now or hereafter prescribed, governing United States certificates.

III. SUBSCRIPTION AND ALLOTMENT

1. Subscriptions will be received at the Federal Reserve Banks and Branches and at the Treasury Department, Washington. Banking institutions generally may

submit subscriptions for account of customers, but only the Federal Reserve Banks and the Treasury Department are authorized to act as official agencies.

2. The Secretary of the Treasury reserves the right to reject any subscription, in whole or in part, to allot less than the amount of certificates applied for, and to close the books as to any or all subscriptions at any time without notice; and any action he may take in these respects shall be final. Subject to these reservations, all subscriptions will be allotted in full. Allotment notices will be sent out promptly upon allotment.

IV. PAYMENT

1. Payment at par for certificates allotted hereunder must be made on or before January 2, 1948, or on later allotment, and may be made only in Treasury Certificates of Indebtedness of Series A-1948, maturing January 1, 1948, which will be accepted at par, and should accompany the subscription. The full year's interest on the certificates surrendered will be paid to the subscriber following acceptance of the certificates.

V. GENERAL PROVISIONS

1. As fiscal agents of the United States, Federal Reserve Banks are authorized and requested to receive subscriptions, to make allotments on the basis and up to the amounts indicated by the Secretary of the Treasury to the Federal Reserve Banks of the respective Districts, to issue allotment notices, to receive payment for certificates allotted, to make delivery of certificates on full-paid subscriptions allotted, and they may issue interim receipts pending delivery of the definitive certificates.

2. The Secretary of the Treasury may at any time, or from time to time, prescribe supplemental or amendatory rules and regulations governing the offering, which will be communicated promptly to the Federal Reserve Banks.

JOHN W. SNYDER,
Secretary of the Treasury.

TREASURY DEPARTMENT

Washington

FOR RELEASE, MORNING NEWSPAPERS,
Friday, December 19, 1947.

Press Service
No. S-570

The Secretary of the Treasury, by this public notice, invites tenders for $1,100,000,000, or thereabouts, of 90-day Treasury bills, for cash and in exchange for Treasury bills maturing December 26, 1947, to be issued on a discount basis under competitive and non-competitive bidding as hereinafter provided. The bills of this series will be dated December 26, 1947, and will mature March 25, 1948, when the face amount will be payable without interest. They will be issued in bearer form only, and in denominations of $1,000, $5,000, $10,000, $100,000, $500,000, and $1,000,000 (maturity value).

Tenders will be received at Federal Reserve Banks and Branches up to the closing hour, two o'clock p.m., Eastern Standard time, Monday, December 22, 1947. Tenders will not be received at the Treasury Department, Washington. Each tender must be for an even multiple of $1,000, and in the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e. g., 99.925. Fractions may not be used. It is urged that tenders be made on the printed forms and forwarded in the special envelopes which will be supplied by Federal Reserve Banks or Branches on application therefor.

Tenders will be received without deposit from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. Tenders from others must be accompanied by payment of 2 percent of the face amount of Treasury bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

Immediately after the closing hour, tenders will be opened at the Federal Reserve Banks and Branches, following which public announcement will be made by the Secretary of the Treasury of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection thereof. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and his action in any such respect shall be final. Subject to these reservations, non-competitive tenders for $200,000 or less without stated price from any one bidder will be accepted in full at the average price (in three decimals) of accepted competitive bids. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank on December 26, 1947, in cash or other immediately available funds or in a like face amount of Treasury bills maturing

December 26, 1947. Cash and exchange tenders will receive equal treatment. Cash adjustments will be made for differences between the par value of maturing bills accepted in exchange and the issue price of the new bills.

The income derived from Treasury bills, whether interest or gain from the sale or other disposition of the bills, shall not have any exemption, as such, and loss from the sale or other disposition of Treasury bills shall not have any special treatment, as such, under the Internal Revenue Code, or laws amendatory or supplementary thereto. The bills shall be subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but shall be exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority. For purposes of taxation the amount of discount at which Treasury bills are originally sold by the United States shall be considered to be interest. Under Sections 42 and 117 (a) (1) of the Internal Revenue Code, as amended by Section 115 of the Revenue Act of 1941, the amount of discount at which bills issued hereunder are sold shall not be considered to accrue until such bills shall be sold, redeemed or otherwise disposed of, and such bills are excluded from consideration as capital assets. Accordingly, the owner of Treasury bills (other than life insurance companies) issued hereunder need include in his income tax return only the difference between the price paid for such bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made, as ordinary gain or loss.

Treasury Department Circular No. 418, as amended, and this notice, prescribe the terms of the Treasury bills and govern the conditions of their issue. Copies of the circular may be obtained from any Federal Reserve Bank or Branch.

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TREASURY DEPARTMENT

Washington

FOR IMMEDIATE RELEASE,
Tuesday, December 23, 1947.

Press Service
No. S-571

President Truman has conferred on Clifton E. Mack, Director of the Treasury's Bureau of Federal Supply, the Medal of Merit for exceptional service to the Government during the war.

Presentation of the award was made today in a surprise ceremony at the Bureau of Federal Supply Offices by Edward H. Foley, Jr., Assistant Secretary of the Treasury.

Crediting Mr. Mack with "aggressive leadership" in directing procurement activities of vitally needed goods, the citation said that Mr. Mack's efforts were responsible for rushing the much needed items to our own armed forces and which "turned out to be of such great help in driving the enemy out of Casserine Pass in Africa and into the sea."

With the passage of the Lend-Lease Act in March of 1941, the Bureau of Federal Supply, then known as the Procurement Division, undertook the immediate purchase of fire fighting equipment to save London from the impending blitz. It sought raw industrial materials, such as steel, lumber, chemicals, hand tools and heavy industrial machinery. The Bureau, under Mr. Mack's direction, became one of the major purchasing organizations in the war structure, buying nearly 8 billion dollars worth of chemicals, metals, vehicles and nearly 50,000 other items. Included in the vast operation were purchases of such things as aluminum rolling mills, entire railroads, a tire manufacturing plant, refining equipment and many others.

During the war, Mr. Mack was named by former Secretary Henry Morgenthau, Jr., to be the Treasury Member of the Procurement Policy Committee which, under the chairmanship of Donald M. Nelson, advised the President on purchase policies.

In addition, Mr. Mack was instrumental in calling into the Federal service outstanding industrial purchasing agents to help the mammoth procurement program then under way.

A career civil servant, Mr. Mack entered the Government in 1927 as a member of the Treasury's Intelligence Unit, Bureau of Internal Revenue. He rose rapidly to the post of Special Agent in Charge of the New England Division. In 1940 he conducted a special survey of the Procurement Division's purchasing activities and then became Director of the organization.

A combat pilot in the First World War, Mr. Mack is also a graduate of the Suffolk Law School in Boston, Massachusetts. He is responsible for the national supply system now operating within Government, whereby civilian agencies of the Federal establishment are supplied with items they commonly use from 12 strategically placed Treasury warehouses.

Mr. Mack is a member of the National Association of Purchasing Agents and a past President of the Washington Chapter of that organization. He more recently has, in conjunction with the National Institute of Governmental Purchasing, laid plans for a National Academy of Public Purchasing, the first sessions of which will begin shortly after the new year and which will disseminate uniform purchasing information to officials in States, Counties and Municipalities.

The citation accompanying The Medal for Merit follows:

CLIFTON E. MACK, for exceptionally meritorious conduct in the performance of outstanding services to the United States from March 25, 1941 to December 31, 1946. Mr. Mack, as Director of Treasury Procurement, later the Bureau of Federal Supply, through his inspirational leadership and guidance, rallied his various officers, aides, purchasing agents and all Procurement employees in Washington, and in all Regional Offices throughout the United States, in the purchase and expeditious shipment of war and other essential supplies for our Allies and our armed forces. By his brilliant foresight, initiative, and great ability, he played an outstanding part in providing all Allied armed forces with necessary war materials and equipment as quickly as possible. Under his aggressive leadership and diligent efforts, much needed supplies were rushed to our own armed forces which turned out to be of such great help in driving the enemy out of Casserine Pass in Africa and into the sea. Mr. Mack's achievements and fine executive ability, together with his patriotic devotion to duty reflect the highest credit upon him and the Government of the United States.

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TREASURY DEPARTMENT
Washington

FOR IMMEDIATE RELEASE,
Monday, December 22, 1947.

Press Service
No. S-572

Six Bureau of Engraving and Printing employees today received money awards totaling $530 under the Treasury Department's "Cash Awards for Suggestions Program." The six contributed ideas for the betterment of essential work in the Bureau of Engraving and Printing which will save the Government many thousands of dollars annually.

Recipients of the awards are:

John J. Carow, Plate Printing Division, $10.

Clifford E. Cole, Surface Printing Division, $375.

Charles H. Kissner, Surface Printing Division, $50.

Ernest Sizemore, Surface Printing Division, $75.

Mrs. Helen B. Tanner, Plate Printing Division, $10.

Ralph E. Tayne, Construction and Maintenance Division, $10.

The $375 award to Clifford Cole was for a suggestion that a reduced size of paper be used in the production of internal revenue stamps for cigarettes. Cole's idea will lead to a saving estimated at $30,000 a year.

Recommendations for the six awards originated in the Bureau of Engraving and Printing and received approval of the Departmental Committee on Employee Awards.

Presentations were made at lunch time today by the superintendents under whom the employees work.

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TREASURY DEPARTMENT
Bureau of Internal Revenue
Washington

FOR RELEASE: MORNING NEWSPAPERS
Wednesday, December 24, 1947

Press Service
No. S-573

George J. Schoeneman, Commissioner of Internal Revenue, announced today plans for authorizing department stores and other qualified retailers to use the last-in-first-out (commonly called LIFO) method of valuing inventories for income tax purposes.

The first step was the publication today in the Federal Register of a proposed amendment to the income tax regulations which would authorize retailers to use this method, provided they use sound statistical procedures in operating the LIFO method. In adopting this policy, the Commissioner gave consideration to the principles stated by the Tax Court in the case of Hutzler Brothers Company vs. Commissioner (8 T.C. No. 3). In this case the Court expressed the belief that the LIFO inventory method could be adapted to retail business provided suitable statistical procedures were used.

To provide a suitable basis for the retail use of the LIFO method, representatives of the Bureau of Internal Revenue, the Bureau of Labor Statistics of the Department of Labor, and representatives of retail organizations have arranged for the compilation of price indices. The Bureau of Labor Statistics will compile and publish the statistics, the retailers will bear the cost of the statistical work, and the Bureau of Internal Revenue will accept these indices as a suitable basis for the use of the LIFO inventory method by retailers.

Under the administrative procedures act, the proposed regulation, as published in today's Federal Register, will be held open for 30 days in order to give interested retailers and others an opportunity to submit comments and suggestions which will be given consideration before the final promulgation of the amended regulation. Such comments and suggestions should be submitted in duplicate to the Commissioner of Internal Revenue, Washington, D. C.

In order to assist interested persons in understanding the methods and principles involved in the proposed regulation, there is attached a memorandum which, subject to modification on the basis of comments received from interested parties within the next 30 days, is intended to be the basis for an official mimeograph defining the use of the LIFO method by retailers.

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Use of LIFO Inventory Method by Taxpayers Also Using Retail Inventory Method

Section 22(d)(1) of the Internal Revenue Code provides an elective method for inventorying goods commonly referred to as the last-in-first-out, or LIFO, inventory method. Section 22(d)(2)(A) of the Code provides that the elective method shall be applied only with respect to the goods specified by the taxpayer in an application filed with the Commissioner. The Commissioner's regulations with respect to the elective inventory method have heretofore made no provision for retailers to group such goods into classes. The Bureau has held that the use of the elective inventory method was not available to taxpayers whose inventory records are kept on the basis of the retail inventory method permitted under section 29.22(c)-8 of Regulations 111 and section 19.22(c)-8 of Regulations 103.

The decision of The Tax Court in the case of Hutzler Brothers Company, 8 T.C. No. 3, held that the position of the Commissioner was untenable in prohibiting the use of the elective inventory method by a taxpayer also using the retail inventory method. The grouping of goods by classes under the retail inventory method necessarily involves the use of some type of index numbers for measuring the extent of price changes in the various classes of goods concerned. The decision laid down no rule concerning the nature or type of index numbers which might be proper, nor did it prescribe other details of methods for applying the LIFO method in the case of retail merchants.

The proposed Treasury Decision published today in the Federal Register proposes to amend Regulations 103 and 111 to expressly permit the use of the elective inventory method by taxpayers also using the retail inventory method. Certain principles are laid down for the application of the elective inventory method by such taxpayers. First, since the elective method requires cost, the retail selling prices of goods included in the opening inventory and purchased during the year must be adjusted for mark-downs as well as mark-ups during the year without regard to the taxpayer's previous practice with respect to mark-downs under the retail method. Second, the price indices employed in the adjustment of the apparent cost of goods in the closing inventory for price changes taking place during the year must be shown to the satisfaction of the Commissioner to be acceptable. Any price indices must be based upon sound statistical principles of construction and upon adequate records, available for examination by the Bureau.

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Use of LIFO Inventory Method by
Taxpayers also using retail inventory
method

Arrangements have been made between representatives of the retail trade and the United States Bureau of Labor Statistics for that agency to compute and publish a series of group index numbers of retail prices, on a country-wide basis, suitable for use by individual department stores, which will be acceptable to the Commissioner. These index numbers will cover the period from 1940 to the present on a semi-annual basis, and will appear semi-annually in the future. The use of such indices of the Bureau of Labor Statistics is not mandatory; indices may be prepared by an individual taxpayer based upon his own data on prices and inventory quantities, if adequate, and if proof is shown that sound statistical methods have been employed that assure reliable indices, not only in the year in question, but in future years. Retailers who have filed, on the basis of the elective method, returns for past years which are still open, and who used indices that are not acceptable to the Commissioner, may file amended returns employing acceptable indices.

It is expected that the Bureau of Labor Statistics will publish its group indices for department stores for the years 1940 to 1947, inclusive, on or about December 31, 1947, and the semi-annual indices for January 15 and July 15 thereafter on or about March 1 and September 1, respectively, of each year. Indices as of the 15th of a month will be deemed to be representative of prices at either the beginning or end of the month in question.

The following groups are under consideration by the Bureau of Labor Statistics as the tentative basis for the preparation of the proposed indices for past years for use by department stores:

(1) Piece Goods
(2) Domestics and Linens
(3) Shoes
(4) Drugs and Toilet Articles
(5) Women's Accessories
(6) Women's Underwear
(7) Women's Outerwear
(8) Men's Wear
(9) Housefurnishings
(10) Appliances
(11) Miscellaneous

Beginning with January 1948 price data will be gathered on additional commodities that may allow the segregation of additional groups.

In using such group indices, a department store taxpayer will apply to the inventory data for each of his departments separately, in the manner described below, the index for the group in which the department logically belongs. A given group index may be applicable to a number of departments in a given store.

Use of LIFO Inventory Method by
Taxpayers also using retail inventory
method

The method of making the price adjustments to the closing inventory values under the retail inventory method, combined with the elective (LIFO) method, is illustrated in Exhibits A and B attached, for three hypothetical departments. In the first two departments there was an increase in the physical quantity of inventory during the year in question, as shown by the comparison of the adjusted retail value at the end of the year and the retail value at the beginning of the year. In the first department prices rose during the year, as shown by the index, while in the second, prices fell. In the third department there was a decline in the physical quantity of inventory.

These illustrations are intended to show the main principles involved in the LIFO adjustments to retail inventories, and are not intended to cover all accounting details of computations which may be required, particularly in later years, under the elective method.

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Exhibit A

Method of Computing LIFO, Retail Inventory

Step No.	Item or Computation	Department No. 1 Women's Shoes	2 Men's Furnishings	3 Linens
	I. Data from taxpayer's books:			
1.	Opening inventory - retail value	$25,000	$40,000	$10,000
2.	" " - mark-on percent	43.6%	45.2%	44.1%
3.	" " - cost (1 reduced by 2)	$14,100	$21,920	$ 5,590
4.	Mark-on on year's purchases (see step 12a)	44.7%	44.8%	44.6%
5.	Closing inventory - retail value	$36,000	$39,400	$10,400
6.	" " - mark-on percent	44.4%	44.9%	44.4%
7.	" " - cost (FIFO) (5 reduced by 6)	$20,016	$21,709	$ 5,782
	II. Price Index Data:			
8.	Price index, closing date relative to opening date	108.4%	96.3%	113.7%
	III. LIFO Computations:			
9.	Closing inventory - adjusted retail value (5 ÷ 8)	$33,210	$40,914	$ 9,147
10.	Increase (decrease) in year (9 - 1)	8,210	914	(853)
11.	Increase at current prices (10 x 8)	8,900	880	-
12a.	Cost of increase (11 reduced by 4)	4,922	486	-
12b.	Cost of decrease (10 reduced by 2)	-	-	(477)
13.	LIFO closing inventory (3 + 12a or 3 - 12b)	19,022	22,406	5,113

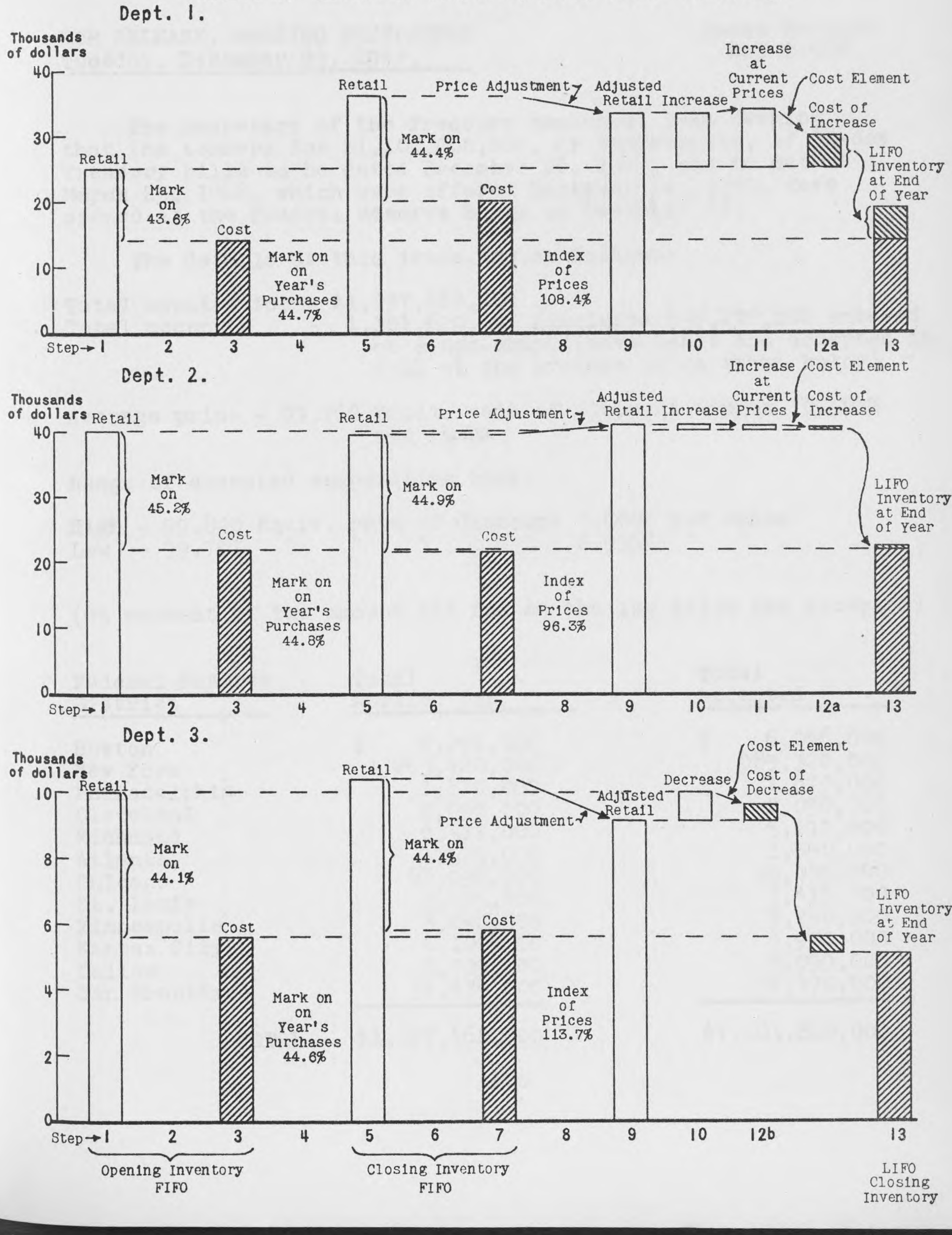
Notes: (a) The mark-ons in steps 2 and 4 must be computed taking account of mark-downs as well as mark-ups.

(b) In succeeding years the data to be used in step 3 will reflect the amounts shown for the preceding year in steps 3 and 12 rather than being computed from steps 1 and 2.

(c) Steps 6 and 7 are shown to allow comparison of LIFO and FIFO inventories.

(d) The index in step 8 is the index of retail prices applicable to the goods in each department, showing the level of prices at the end of the year (108.4% in department 1) relative to the beginning of the year (100%).

Exhibit B. Method of Computing LIFO, Retail Inventory.



TREASURY DEPARTMENT

Washington

FOR RELEASE, MORNING NEWSPAPERS
Tuesday, December 23, 1947.

Press Service
No. S-574

The Secretary of the Treasury announced last evening that the tenders for $1,100,000,000, or thereabouts, of 90-day Treasury bills to be dated December 26, 1947, and to mature March 25, 1948, which were offered December 19, 1947, were opened at the Federal Reserve Banks on December 22.

The details of this issue are as follows:

Total applied for - $1,397,460,000
Total accepted - 1,101,620,000 (includes $36,272,000 entered on a non-competitive basis and accepted in full at the average price shown below)

Average price - 99.762 Equiv. rate of discount approx. 0.951% per annum

Range of accepted competitive bids:

High - 99.800 Equiv. rate of discount 0.800% per annum
Low - 99.761 " " " " 0.956% " "

(65 percent of the amount bid for at the low price was accepted)

Federal Reserve District	Total Applied for	Total Accepted
Boston	$ 6,291,000	$ 6,046,000
New York	1,263,420,000	985,320,000
Philadelphia	1,870,000	1,870,000
Cleveland	2,058,000	2,058,000
Richmond	6,311,000	5,111,000
Atlanta	1,575,000	1,550,000
Chicago	62,996,000	49,036,000
St. Louis	3,415,000	3,415,000
Minneapolis	3,240,000	2,740,000
Kansas City	6,100,000	4,900,000
Dallas	5,709,000	5,099,000
San Francisco	34,475,000	34,475,000
TOTAL	$1,397,460,000	$1,101,620,000

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TREASURY DEPARTMENT

Washington

FOR RELEASE, MORNING NEWSPAPERS, Friday, December 26, 1947.

Press Service No. S-575

The Secretary of the Treasury, by this public notice, invites tenders for $1,300,000,000, or thereabouts, of 90-day Treasury bills, for cash and in exchange for Treasury bills maturing January 2, 1948, to be issued on a discount basis under competitive and non-competitive bidding as hereinafter provided. The bills of this series will be dated January 2, 1948, and will mature April 1, 1948, when the face amount will be payable without interest. They will be issued in bearer form only, and in denominations of $1,000, $5,000, $10,000, $100,000, $500,000, and $1,000,000 (maturity value).

Tenders will be received at Federal Reserve Banks and Branches up to the closing hour, two o'clock p.m., Eastern Standard time, Monday December 29, 1947. Tenders will not be received at the Treasury Department, Washington. Each tender must be for an even multiple of $1,000, and in the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e. g., 99.925. Fractions may not be used. It is urged that tenders be made on the printed forms and forwarded in the special envelopes which will be supplied by Federal Reserve Banks or Branches on application therefor.

Tenders will be received without deposit from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. Tenders from others must be accompanied by payment of 2 percent of the face amount of Treasury bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

Immediately after the closing hour, tenders will be opened at the Federal Reserve Banks and Branches, following which public announcement will be made by the Secretary of the Treasury of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection thereof. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and his action in any such respect shall be final. Subject to these reservations, non-competitive tenders for $200,000 or less without stated price from any one bidder will be accepted in full at the average price (in three decimals) of accepted competitive bids. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank on January 2, 1948, in cash or other immediately available funds or in a like face amount of Treasury bills maturing January 2, 1948. Cash and exchange tenders will receive equal treatment. Cash adjustments will be made for differences between the par value of maturing bills accepted in exchange and the issue price of the new bills.

The income derived from Treasury bills, whether interest or gain from the sale or other disposition of the bills, shall not have any exemption, as such, and loss from the sale or other disposition of Treasury bills shall not have any special treatment, as such, under the Internal Revenue Code, or laws amendatory or supplementary thereto. The bills shall be subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but shall be exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority. For purposes of taxation the amount of discount at which Treasury bills are originally sold by the United States shall be considered to be interest. Under Sections 42 and 117 (a) (1) of the Internal Revenue Code, as amended by Section 115 of the Revenue Act of 1941, the amount of discount at which bills issued hereunder are sold shall not be considered to accrue until such bills shall be sold, redeemed or otherwise disposed of, and such bills are excluded from consideration as capital assets. Accordingly, the owner of Treasury bills (other than life insurance companies) issued hereunder need include in his income tax return only the difference between the price paid for such bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made, as ordinary gain or loss.

Treasury Department Circular No. 418, as amended, and this notice, prescribe the terms of the Treasury bills and govern the conditions of their issue. Copies of the circular may be obtained from any Federal Reserve Bank or Branch.

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TREASURY DEPARTMENT

Washington

FOR IMMEDIATE RELEASE
Wednesday, December 24, 1947

Press Service
No. S-576

On October 16 and 17, 1947, a conference was held at the Bureau of Customs regarding the classification of Cordova wool for tariff purposes. The Bureau has affirmed that the Cordova wool provided for in paragraph 1101(a), Tariff Act of 1930, as amended, is the same as that designated as Cordova in corresponding provisions of previous tariff acts. This type of wool is represented by official sample 301.

It is anticipated that this ruling will remove uncertainty in the trade as to the character of wool classifiable as Cordova and entitled to entry under bond without payment of duty for use in the manufacture of carpets and other articles enumerated in paragraph 1101(b) of the tariff act.

TREASURY DEPARTMENT

Washington

FOR IMMEDIATE RELEASE,
Friday, December 26, 1947.

Press Service
No. S-577

Secretary Snyder today proclaimed the figure to be used in computing the "reserve and other policy liability credit" of life insurance companies under the Federal income tax for the taxable year 1947. This figure, determined from year to year in accordance with a formula set up under statutory provisions, governs the portion of net investment income which life insurance companies are allowed as a deduction for earnings needed to maintain their reserves and meet commitments to policyholders. The figure proclaimed for 1947 is 1.0066. As in previous years, the proclamation was made in the form of a Treasury decision.

In connection with the proclamation, the Secretary issued the following statement:

"Since the figure 1.0066 determined under T.D. 5595, December 19, 1947 to be used by life insurance companies in computing their reserve and other liability credit for the taxable year 1947 is in excess of one, it will result in deductions in excess of the net investment income on life insurance reserves. This will not only have the effect of entirely relieving life insurance companies from Federal income tax with respect to their life insurance investment income, but will also exempt them in considerable part from tax on investment income derived from non-life insurance reserves. Under the 1947 reserve and other policy liability credit ratio, only a small proportion of companies, those doing a relatively large volume of accident and health insurance business, will pay any Federal income tax for 1947. This development raises questions of public policy with respect to the method of taxing life insurance companies which call for the immediate attention of the Congress and others concerned. Representatives of the life insurance industry at their request have already conferred with the Treasury with regard to these problems.

"The figure for 1947 has been determined in accordance with the provisions of Section 202 (b) of the Internal Revenue Code, as amended by Section 163 of the Revenue Act of 1942, on the basis of representative data furnished by life insurance companies on their income tax returns for 1946. The figure for 1947 is in all respects consistent with corresponding figures determined for previous taxable years as follows: 1946, .9595; 1945, .9539; 1944, .9261; 1943, .9198; 1942, .93. Under the law, I have no alternative but to determine such a figure. However, the unavoidable result is the effective removal of Federal income tax liability from life insurance companies.

"The present taxing formula applicable to life insurance companies is based on conditions existing at the time of its adoption in 1942. I am confident that the life insurance industry will cooperate with the Treasury and the Congress in developing revised methods of taxation that will be fair and equitable and will not endanger their obligations to their policyholders."

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TREASURY DEPARTMENT

Washington

FOR IMMEDIATE RELEASE
Friday, December 26, 1947.

Press Service
No. S-578

Secretary Snyder today issued the following statement:

The story in reference to Treasury recommendations on tax reduction which appeared in today's afternoon papers is the figment of an active imagination.

The Treasury Department has reached no conclusions on recommendations to the President on tax matters.

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TREASURY DEPARTMENT

Washington

FOR RELEASE, MORNING NEWSPAPERS,
Tuesday, December 30, 1947.

Press Service
No. S-579

The Secretary of the Treasury announced last evening that the tenders for $1,300,000,000, or thereabouts, of 90-day Treasury bills to be dated January 2 and to mature April 1, 1948, which were offered December 26, 1947, were opened at the Federal Reserve Banks on December 29.

The details of this issue are as follows:

Total applied for - $1,635,902,000
Total accepted - 1,303,405,000 (includes $30,376,000 entered on a non-competitive basis and accepted in full at the average price shown below)

Average price - 99.762 Equiv. rate of discount approx. 0.952% per annum

Range of accepted competitive bids:

High - 99.770 Equiv. rate of discount 0.920% per annum
Low - 99.761 " " " " 0.956% " "

(61 percent of the amount bid for at the low price was accepted)

Federal Reserve District	Total Applied for	Total Accepted
Boston	$ 2,005,000	$ 2,005,000
New York	1,477,943,000	1,168,463,000
Philadelphia	2,135,000	2,135,000
Cleveland	5,266,000	3,466,000
Richmond	1,279,000	1,279,000
Atlanta	850,000	850,000
Chicago	85,905,000	66,466,000
St. Louis	3,030,000	3,030,000
Minneapolis	6,970,000	6,570,000
Kansas City	22,585,000	22,407,000
Dallas	6,115,000	5,805,000
San Francisco	21,819,000	20,929,000
TOTAL	$1,635,902,000	$1,303,405,000

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TREASURY DEPARTMENT
Washington

FOR RELEASE AFTERNOON NEWSPAPERS
Monday, December 22, 1947

Press Service
No. S-580

Factual and analytic information bearing on Federal income tax exemption levels is contained in a study made public today by the Treasury Department under the title "Individual Income Tax Exemptions." The study sets forth data and considerations helpful in weighing the adequacy and equity of exemptions now in effect. It makes no policy recommendations.

The study presents the increases in consumer prices and living costs since 1939 and discusses the relation of these changes to the adequacy of the present exemption levels. Available information on family budgets is given.

Our war finance program, the study recalls, brought the personal income tax exemptions down to their present record low point. As a simplification move, legislation in 1944 placed exemptions and dependency allowances on a per capita basis. At present the exemption for the taxpayer, his wife and dependents is at the uniform level of $500 each for both normal tax and surtax.

In considering postwar tax revision, the role of the exemptions in the Federal tax system poses a number of specific problems:

(a) The timing of exemption changes in relation to economic and fiscal conditions.

(b) The relative amounts of exemption for single persons, married couples and dependents.

(c) The postwar level of exemptions in the light of revenue requirements and the extent of reliance on the individual income tax as compared with other levies.

(d) The choice between tax rate and exemption adjustments.

Taking the exemptions which prevailed in the income year 1939 as a basis of comparison, the present per capita exemption of $500, without adjustment for price changes, is 50 percent of the 1939 figure in the case of single individuals, 40 percent for married couples, and 125 percent for dependents. Thus the net result of changes since 1939 has been a sharp exemption decrease for single persons and married couples, but a substantial increase in the dependency allowance.

Price increases for goods and services accent the wartime exemption reductions. The value of the exemptions when expressed in terms of purchasing power has suffered a decrease even greater than the decrease in dollar amounts. The amount to which a $500 exemption would have to be adjusted upward to offset the effect of price increases since 1939, 1942, and 1944 is given in the study as being $824, $703, and $653 respectively.

The study presents the best available figures as to three levels of family budgets, these being described as maintenance level, a modest but currently adequate level and so-called health and decency level. Comparisons indicate that the exemptions are substantially below maintenance requirements for a single person without dependents and for a married couple without dependents.

Charts and tables accompanying the study show the budget-exemption comparisons at a glance for various family statuses.

There is detailed consideration in the study of data related to the major issue of whether the present per capita exemption system should be continued, or whether relatively larger exemptions should be accorded to single persons and married persons than to dependents.

Departure from the per capita system would involve some loss of simplification in income tax procedure. However, the study states that a greater exemption for principals than for dependents would provide relief where it appears to be most needed with a minimum sacrifice of revenue.

Certain types of exemption combinations which depart form the per capita system are cited, under which considerable simplification could be preserved. Illustrations of such exemption systems are: $800 for a single person, $1,600 for a married couple, and $400 for a dependent, $800 for a single person, $1,200 for a married couple and $400 for a dependent. The first of these combinations would reduce revenue, number of taxpayers and the total tax base to roughly the same extent as would an increase in the per capita exemption from $500 to $700. The second would be comparable in its effects to a per capita exemption of $600.

Tables are attached showing such pertinent information as the exemption allowances since the inception of the income tax in this country in 1913, and the comparative exemption experience of the United States, Canada and Great Britain since 1939.

INDIVIDUAL INCOME TAX EXEMPTIONS

Division of Tax Research, Treasury Department
December 1947

Individual Income Tax Exemptions

A major issue in individual income tax policy relates to the level and structure of personal exemptions. It is the purpose of this study to bring together the available factual information bearing on the adequacy of the existing exemptions and to discuss the various revenue, equity, economic, and administrative considerations raised by alternative methods of revising the exemptions. No policy recommendations are made in this study, which is designed to provide factual and analytic background material which may be helpful in formulating such recommendations.

This study was prepared in the Individual Income Tax Section of the Division of Tax Research. The revenue estimates used in the study were supplied by the Office of the Technical Staff. Valuable assistance and suggestions were received from other members of the Treasury tax staff, including consultation with members of the Office of Tax Legislative Counsel on legal matters and of the Bureau of Internal Revenue on administrative matters.

This subject has also been considered by a committee composed of the technical tax staffs of the Treasury Department and the Joint Committee on Internal Revenue Taxation. An early draft of this study was made available to the committee and it has benefited at various points by the committee's discussions. The material contained herein, however, is not to be considered as representing in any way the views of the staff of the Joint Committee on Internal Revenue Taxation.

Division of Tax Research
U. S. Treasury Department

Individual Income Tax Exemptions

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TABLES - continued

Individual Income Tax Exemptions

Summary

1. Wartime reduction in exemptions

One of the most striking features of the war finance program was the reduction in personal exemptions under the individual income tax. At the low point reached under the Individual Income Tax Act of 1944, all persons with net income above a flat $500 exemption were subject to normal tax. Under present law the taxpayer is allowed an exemption of $500 each, for himself, his wife, and dependents for both normal tax and surtax.

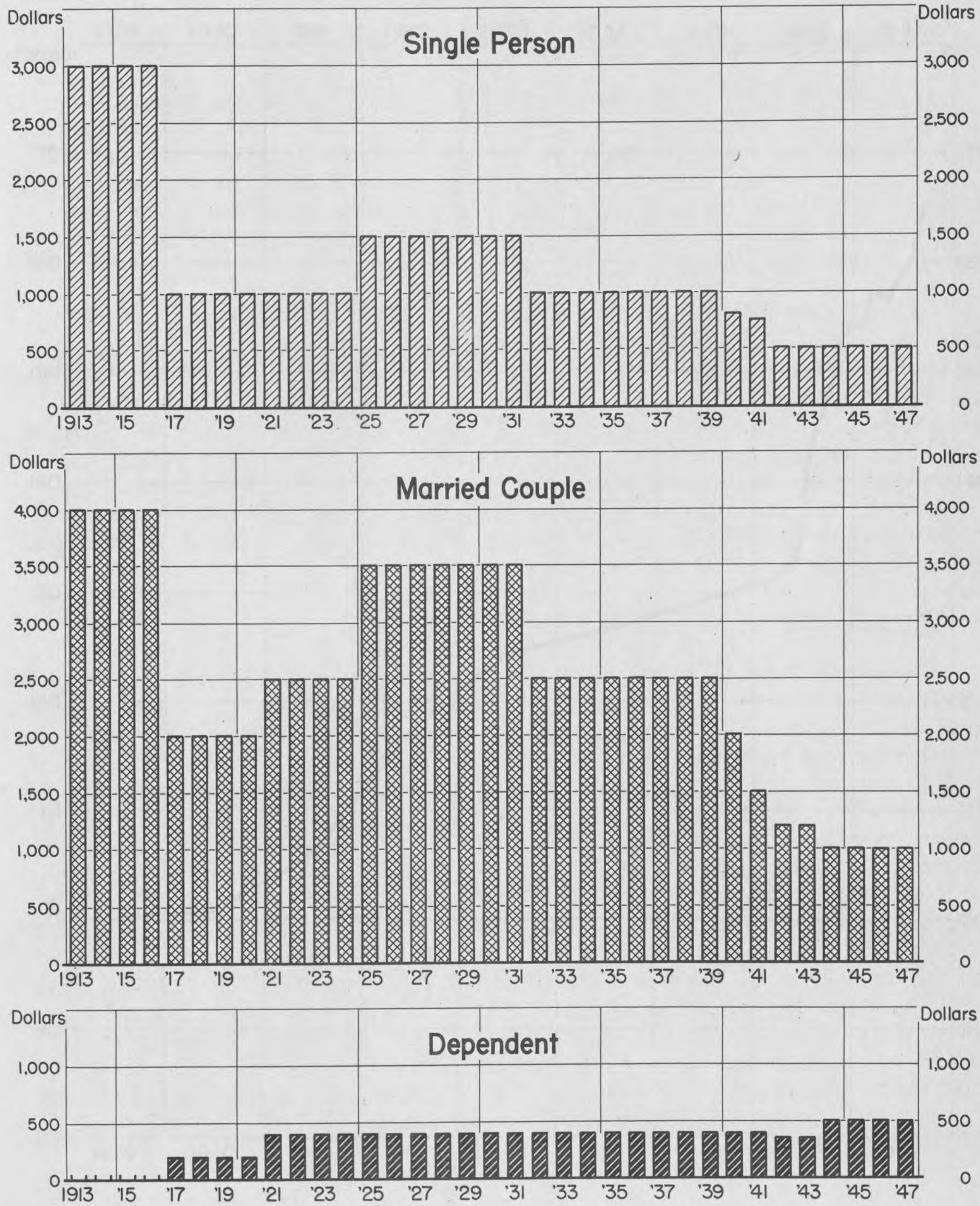
Additional information on the war period developments is given in Chart 1, page ii, which summarizes the exemption provisions under the Federal individual income tax for the entire period 1913-1947. Taking the exemptions which prevailed in the income year 1939 as a basis of comparison, the present exemption, without adjustment for price changes, is 50 percent of the 1939 figure in the case of single individuals, 40 percent for married couples, and 125 percent for dependents. The net result of exemption revisions since 1939 has been a sharp decrease in exemptions for single persons and married couples, but a substantial increase in the dependent exemption.

2. Exemptions and the increase in living costs

To appreciate fully the extent of the wartime reduction in exemption levels it is necessary to take into account not merely the dollar decrease in exemptions but the even greater decrease in the value of the exemptions when expressed in terms of goods and services. The rise in the cost of living has sharply reduced the command of the dollar exemptions over goods and services. While this development may have imposed income tax at real income levels not necessarily intended when the present exemptions were adopted, it is in accord with the view of those who held that the income tax base should have been further broadened. The increase in consumer prices 1939-September 1947 is shown in Chart 2, page iii. The amount to which a $500 exemption would have to be adjusted upward merely to offset the effect of price increases since 1939, 1942 and 1944 is indicated in Chart 3, page iv, as being $824, $703, and $653, respectively. This chart also compares present exemptions with 1939 exemptions adjusted upward to provide the same purchasing power as in 1939. Thus, 1939 exemptions for single persons, married couples, and dependents had the same purchasing power, respectively, as $1,648, $4,120, and $659 had in September 1947.

Chart I

PERSONAL EXEMPTIONS UNDER FEDERAL INDIVIDUAL INCOME TAX, 1913-1946



Note: For periods indicated, personal and dependent exemptions have applied as follows:
1913-1934: Exemptions for normal tax only (surtax began at specified amounts of net income).
1934-1943: Exemptions for both normal tax and surtax (1934-'40 surtax began at $4,000 of surtax net income).
1944-1945: Exemptions of $500 per capita for surtax only; for normal tax, the taxpayer was allowed a flat $500 exemption plus his spouse's income up to $500 if joint return filed; and,
1946-1947: Exemptions of $500 per capita for both normal tax and surtax.

Office of the Secretary of the Treasury
Division of Tax Research

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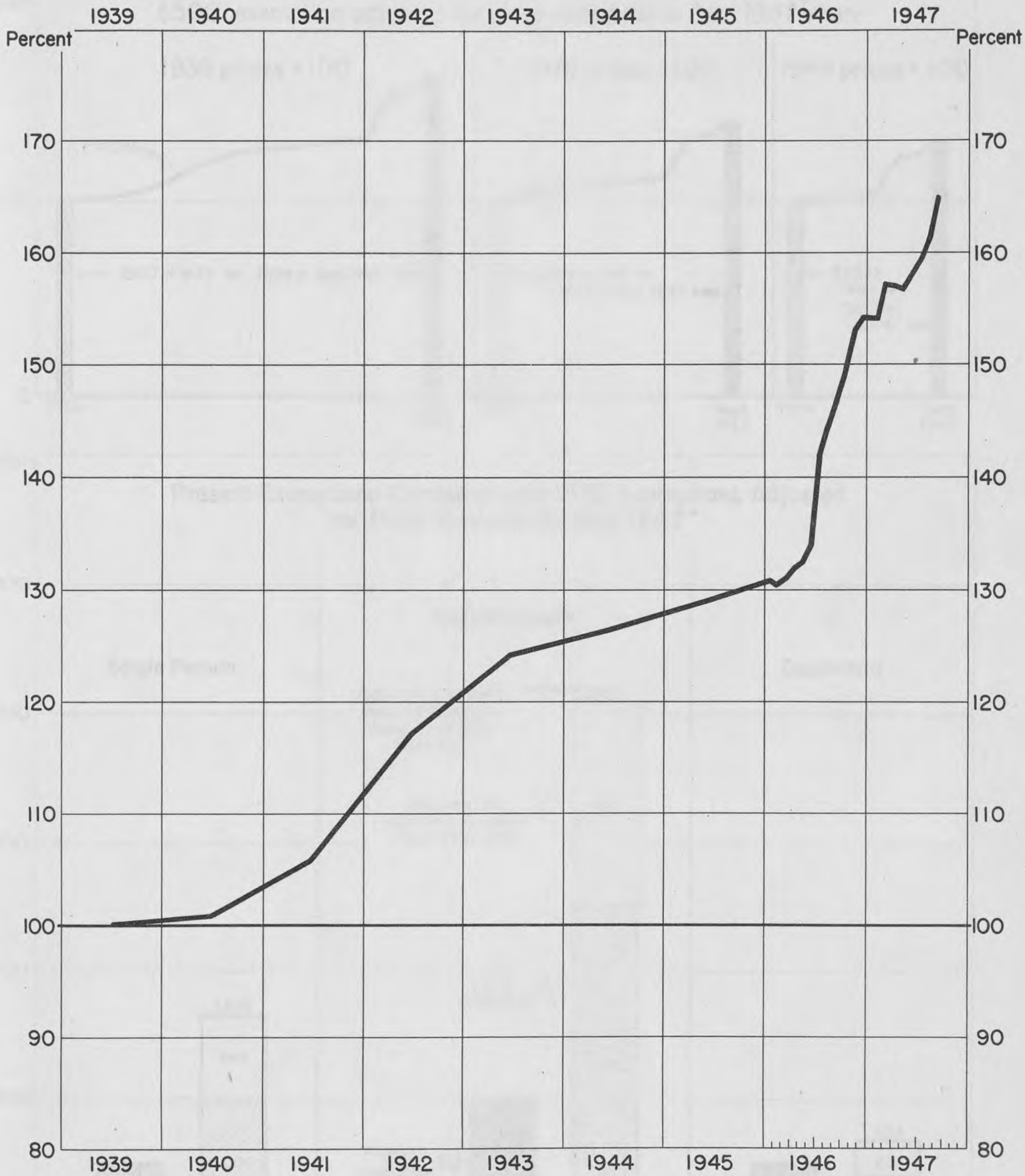
Chart 2

CONSUMERS' PRICE INDEX 1939 - SEPT. 1947

1939 Average = 100



Note: Based on Bureau of Labor Statistics consumers' price index for moderate-income families in large cities, adjusted to 1939 base.

Office of the Secretary of the Treasury
Division of Tax Research

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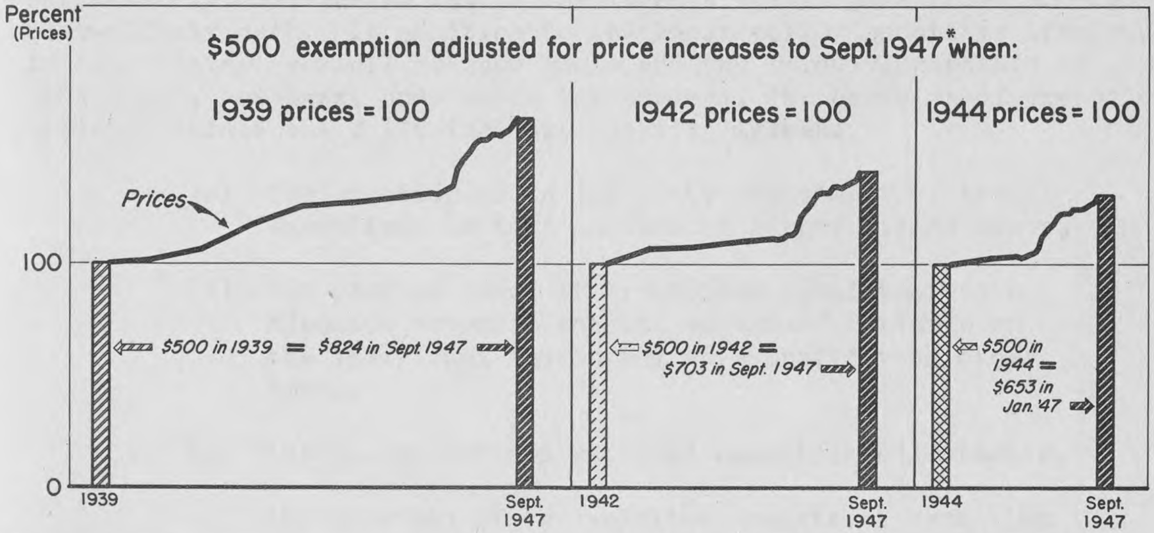
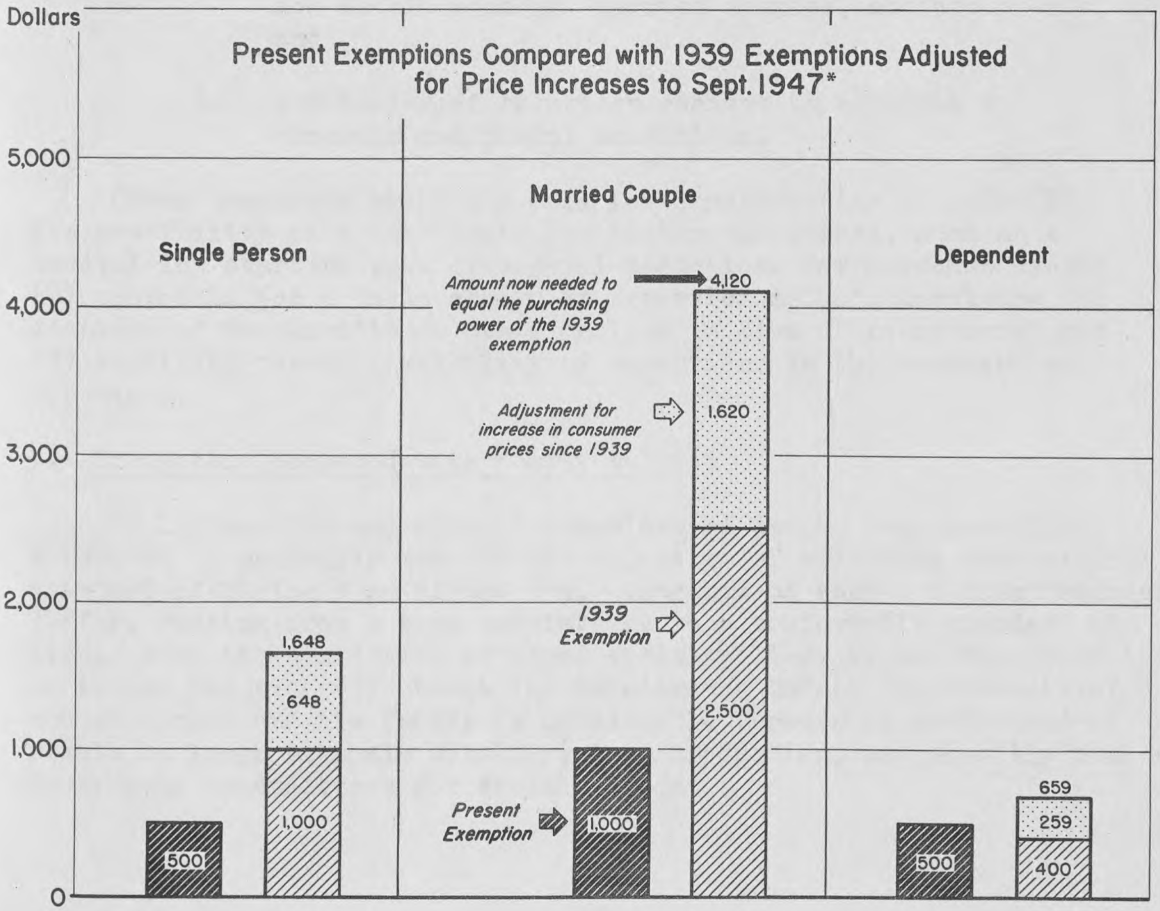
Chart 3

EFFECT OF HIGHER PRICES ON PURCHASING POWER OF EXEMPTIONS





*Adjustments are based on changes in the BLS consumers' price index for moderate-income families in large cities.

3. Specific problems and issues

The individual income tax exemptions are related to the role of the individual income tax in the revenue system as a whole and its over-all strength. In addition to the basic policy questions involved in determining over-all revenue goals and the relative emphasis on individual, business, and excise tax sources, the question of exemption revision raises the following more specific issues:

(a) The question of an immediate adjustment of the exemptions to take account of higher living costs,

(b) the postwar level of exemptions consistent with adequate revenues and the extent of reliance on the individual income tax as compared with other taxes,

(c) the choice between rate and exemption adjustments,

(d) the question of the relative amounts of exemption for single persons, married couples, and dependents, and,

(e) the timing of exemption changes in relation to economic and fiscal conditions.

Other questions which may call for consideration include (1) the possibility of a substitute for higher exemptions, such as a special low starting rate or special deductions for hardship cases; (2) proposals for a basic change in exemption method, involving the adoption of tax credits or other devices in lieu of exemptions; and (3) stability versus flexibility of exemptions in the postwar tax structure.

4. Exemptions compared with family budgets

In legislative and other discussions of income tax exemptions, reference is generally made to the objective of relieving some minimum standard of living from direct tax. Concepts of such a minimum standard differ, ranging from a bare subsistence to a comfortable standard of life. From the standpoint of sound social policy, it has been held that an income tax exemption below the maintenance budget requirements of a manual worker and his family is undesirable because it would tend to result in lower economic vitality, less production, and possibly higher Government expenditures for social purposes.

In Chart 4, page vii, existing exemptions are compared with the latest information (September 1947) available for a maintenance budget level, a modest but currently adequate standard of living for a city worker's family, and a so-called health and decency budget level. 1/ These comparisons indicate that present exemptions are substantially below maintenance requirements for a single individual with no dependents, and for a married couple with no dependents. However, the present $500 dependent exemption apparently exceeds the maintenance requirements for a dependent, so that present exemptions are perhaps within the range of adequacy for married couples with one or two dependents and are more than adequate to cover a maintenance standard for a married couple with more than two dependents. Present exemption levels are substantially below the requirements for the other two higher levels of living for all family sizes.

Family budget data are also useful in throwing light on the question of what relative amounts of exemption should be allowed for single persons, married couples, and dependents, as distinguished from the issue of the dollar amounts or the general level of exemptions. On the basis of the available information with respect to comparable living requirements for different-sized families, summarized in the following table, the present per capita exemption appears to allow relatively too little exemption for single individuals living alone, and relatively too much for dependents, taking the married couple with no dependents as the standard of reference.

Present exemptions compared with Bureau of Labor Statistics estimates of incomes needed to achieve comparable levels of living

(Relatives: married couple, no dependents = 100)

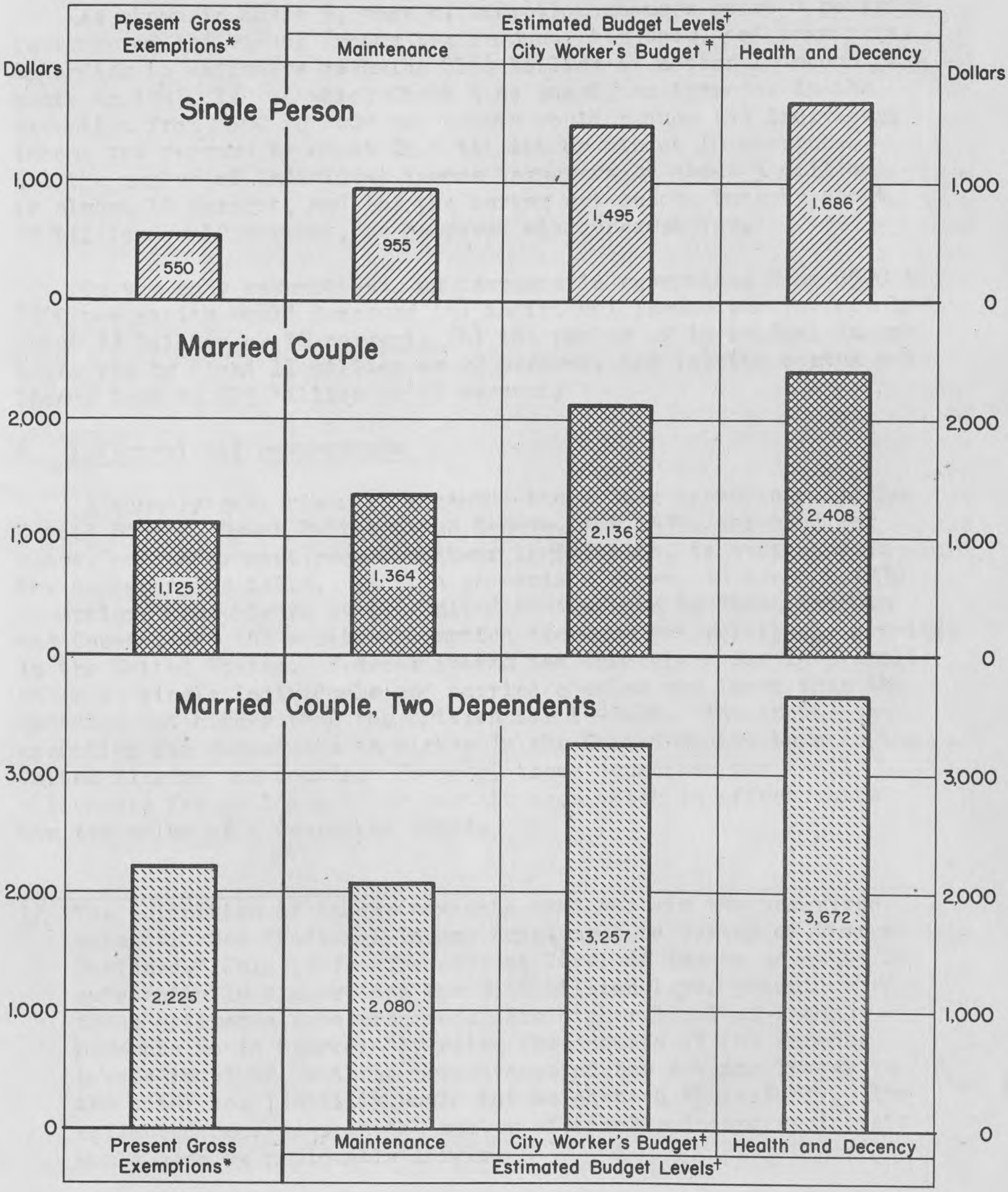
Exemption	Bureau of Labor Statistics estimates a/	Exemptions for single persons, married couples and dependents, respectively, of: $ 500, 1,000, 500	$800, 1,600, 400 (Combination A)	$800, 1,200, 400 (Combination B)
Single, no dependents	70 b/	50	50	67
Married, no dependents	100	100	100	100
Married, 1 dependent	128	150	125	133
Married, 2 dependents	152.5	200	150	167
Married, 3 dependents	174	250	175	200
Married, 4 dependents	194.5	300	200	233

a/ Average of BLS estimates for savings and diet criteria (see Section IIA, pp. 5-6).
b/ Savings criterion only. Diet data not available.

1/ For explanation of these budgets see Section II, pp. 6-13.

Chart 4

PRESENT EXEMPTIONS COMPARED WITH ESTIMATED FAMILY BUDGET LEVELS (Sept. 1947 Prices)



*Minimum level of adjusted gross income subject to tax under 1946 Form 1040 tax table.
†Exclusive of Federal Income tax and adjusted to Sept. 1947 prices on the basis of B.L.S. consumers' price index.
‡A modest but currently adequate budget for a city worker's family.

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5. Revenue, number of taxpayers, and tax base

As shown in Chart 5, page x, exemption changes exert a powerful leverage on individual income tax revenue, tax base, and taxpayers. According to estimates assuming $166 billion of national income payments in 1947, 1/ on which Chart 5 is based, an increase in the exemption from $500 to $600 per capita would reduce (a) individual income tax revenue by about $1.6 billion or almost 10 percent; (b) the number of individual income taxpayers by about 5 million or almost 10 percent, and (c) the surtax net income base by about $8 billion or 12 percent, as compared with present law.

On the same assumptions, an increase in exemptions from $500 to $700 per capita would decrease (a) individual income tax revenue by about $3 billion or 18 percent, (b) the number of individual income taxpayers by about 11 million or 22 percent, and (c) the surtax net income base by $15 billion or 22 percent.

6. International comparisons

A summary comparison of personal income tax exemptions in the United States, Great Britain, and Canada, for 1939, selected war years, and under most recent postwar legislation, is presented in the accompanying table. As this comparison shows, in general 1939 exemptions were higher in the United States than in Great Britain and Canada, and the wartime exemption decrease was relatively greatest in the United States. Federal income tax exemptions for 1947 applicable to single individuals and married couples are lower than the Canadian but higher than the British for 1947-48. The income tax exemption for dependents is higher in the United States than in the United Kingdom and Canada. However, these countries pay family allowances for children under certain ages which in effect raise the tax value of a dependent child.

1/ The definition of income payments used here is the unrevised concept. See "National Income Supplement to Survey of Current Business," July 1947. The current level of income payments is substantially higher than the $166 billion level assumed when these estimates were prepared. The higher level of income payments would appreciably raise the amounts of the revenue losses involved, but the percentages of the revenue losses to the total tax liability would not be changed appreciably. The estimated decreases in the number of taxable income recipients would also be noticeably larger.

Comparison of personal exemptions and credits for dependents in the United States, United Kingdom 1/ and Canada, for 1939, selected war years and 1947

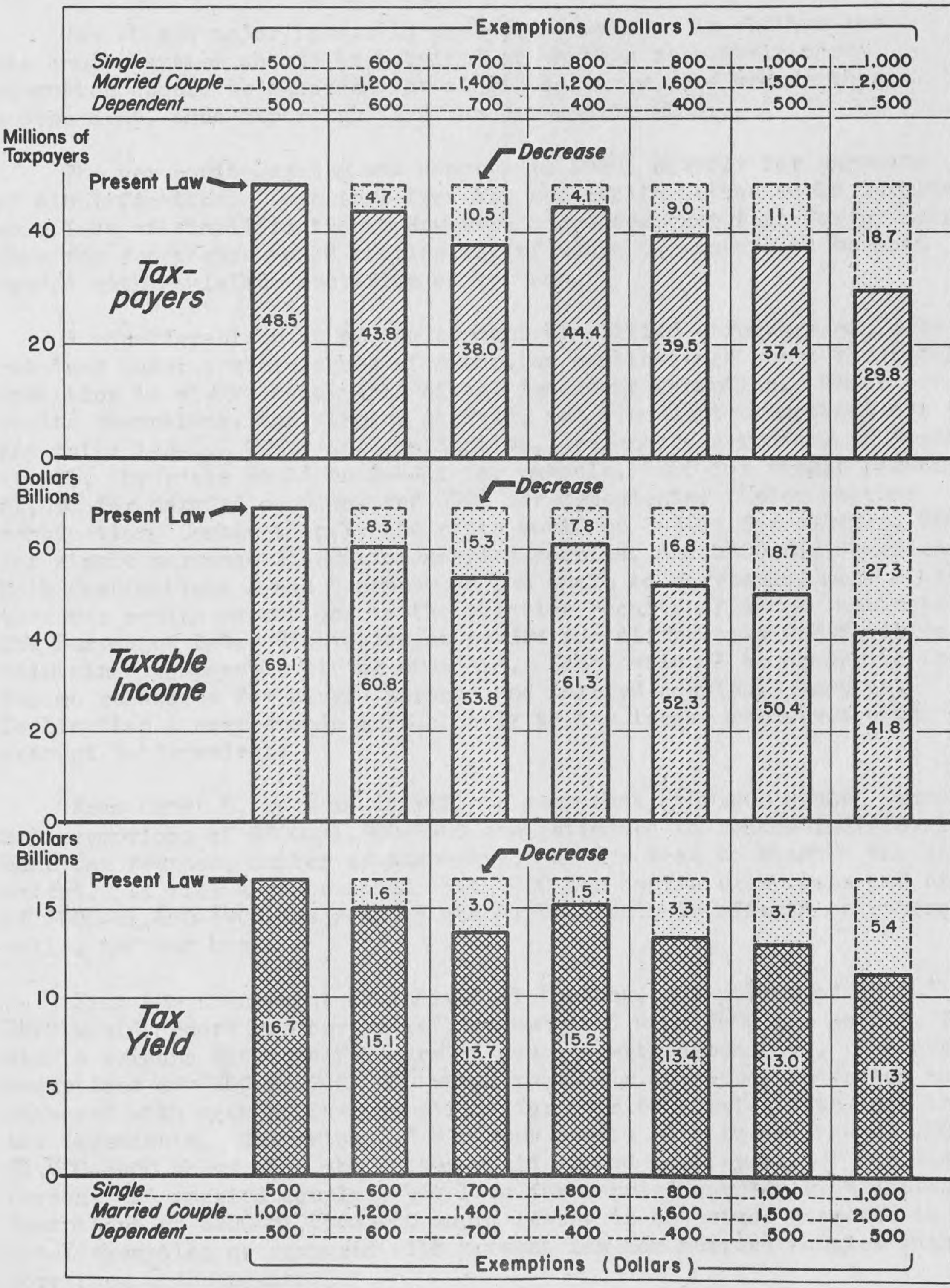
Income year 2/	Personal exemptions						Credit for dependents		
	Single person			Married person					
	United States	United Kingdom	Canada	United States	United Kingdom 3/	Canada	United States	United Kingdom	Canada
1939	$1,000	$400	$1,000	$2,500	$720	$2,000	$400	$240	$400
1940	800	400	750	2,000	680	1,500	400	200	400
1941	750	320	750	1,500	560	1,500	400	200	400
1942	500	320	660	1,200	560	1,200 4/	350	200	5/
1944-45	500	320	660	1,000 6/	560	1,200 4/	500 6/	200	5/
1947	500	440	750	1,000 6/	720	1,500	500 6/	240 7/	(100 8/ (300 9/

1/ Pound converted at $4.
2/ Calendar year in the case of United States and Canada; one-year period beginning April 6 of year shown in the case of the United Kingdom.
3/ If the wife has earned income, the married allowance is increased by amounts up to a maximum of $180 for 1939-42, $320 for 1942-46, and $440 for 1947-48.
4/ Minimum taxable limit, applicable to taxpayers with up to $1,570 of net income. For taxpayers with larger incomes the exemption consisted of an income deduction of $660 plus a tax credit of $150 against the graduated tax starting at 30 percent.
5/ In lieu of an income exemption the following tax credits were deductible from the amount of tax: $28 from normal tax (rate 7 percent) and $80 from graduated tax (initial rate 30 percent).
6/ Surtax exemptions. For surtax, each taxpayer was allowed an exemption of $500, plus $500 for his spouse, and $500 for each dependent. The normal tax exemption was either $500 or up to a maximum of $1,000 if the return included income of both husband and wife. For 1946 and subsequent years, the surtax exemptions were made applicable to the normal tax also.
7/ Since August 6, 1946 a family allowance of $1 a week or $52 a year is paid for each child, other than the eldest, under 16 years of age.
8/ Exemption allowed dependents eligible to receive family allowances. Family allowances average about $72 annually per child under 16 years of age.
9/ Exemption allowed dependents not eligible for family allowances.

Chart 5

EFFECTS OF EXEMPTION INCREASES

Estimates for Individual Income Tax at $166 Billion Income Payments



Source: Office of the Technical Staff

Office of the Secretary of the Treasury
Division of Tax Research

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7. Per capita exemptions contrasted with other systems

One of the major issues in exemption revision is whether the per capita system should be retained or whether relatively more exemption should be accorded the single taxpayer or a spouse than a dependent, thus departing from the per capita plan.

The per capita system was adopted in 1944, chiefly for purposes of simplification. Departure from the per capita method would involve some loss of simplification. However, a greater exemption for principals than for dependents would provide relief where it appears to be most needed with a minimum sacrifice of revenue.

A considerable part of the present simplified structure could be retained under certain types of exemption combinations where the total exemption is always a multiple of the dependent exemption. Under per capita exemptions, the single, married, and dependent exemptions are in the ratio 1-2-1. Under one combination, designated hereafter as Combination A, the ratio would be 2-4-1: for example, $800 for single persons, $1,600 for married couples, and $400 for dependents. Under another combination, Combination B, the ratio would be 2-3-1: for example, $800 for single persons, $1,200 for married couples, and $400 for dependents. Both Combinations A and B appear on the whole to correspond more closely than per capita exemptions to the relative amounts of income estimated by the Bureau of Labor Statistics as needed for different-sized families to maintain a comparable living standard. Combination B is closer to these income relatives for single persons and married couples. However, Combination A corresponds more closely to the income relatives with respect to dependents.

From Chart 5, page x, it will be seen that $600 per capita exemptions and exemptions of $800-$1,200-$400 are estimated to reduce individual income tax revenue, number of taxpayers, and tax base to roughly the same extent. It will also be noted that $700 per capita exemptions and exemptions of $800-$1,600-$400 are roughly comparable in their effects on revenue, tax rolls, and tax base.

From the standpoint of individual burdens, exemptions of $800-$1,200-$400 would accord greater relief, as compared with $600 per capita, for single persons but less for married couples with dependents. Moreover, exemptions of $800-$1,200-$400 would result in an actual reduction as compared with present law exemptions for married couples with more than two dependents. Comparison of $700 per capita with exemptions of $800-$1,600-$400 shows that the latter would accord greater relief for single persons and married couples, but less for married couples with dependents. Exemptions of $800-$1,600-$400 would result in an actual decrease in the total exemption as compared with present law for married couples with more than 6 dependents.

From the standpoint of administration and compliance, Combination A would appear preferable on balance to Combination B. This is due chiefly to the simpler treatment of married couples. Moreover, Combination B is open to the objection on social and equity grounds that it would increase the tax liability of two persons because of marriage.

8. Tax credits in lieu of exemptions

In connection with exemption revision, it may be desirable to give consideration to proposals for tax credits in lieu of exemptions. In typical form, such a proposal would substitute for a given exemption a credit against tax equal to the starting rate times the amount of such exemption. Under such a proposal, the present $500 per capita exemption would be replaced by a credit against tax of $95 per capita.

According to latest available estimates, tax credits of $95 per capita in lieu of present exemptions, with no other change in present law, would increase income tax revenues by about $650 million annually, assuming $166 billion national income payments. Tax credits in lieu of exemptions would thus increase revenue without increasing tax rates, permitting higher effective exemption levels with a given revenue goal. However, tax credits would shift a larger part of the burden to larger as against smaller family units, particularly in the middle-income groups.

Individual Income Tax Exemptions

I. Introduction

A. Wartime experience and current exemption levels

In the period 1940-42 personal exemptions were reduced by successive steps to unprecedented levels. 1/ These reductions were an important part of the fiscal program necessary to meet emergency revenue requirements. In 1944 an adjustment was made in the personal and dependent exemptions as part of the simplification program. Under the 1944 legislation, a flat $500 exemption was allowed for the 3-percent normal tax and $500 per capita for the surtax. Under the Revenue Act of 1945, effective beginning with 1946, the normal tax exemption was raised to equal the surtax exemption. For both the normal tax and surtax, the taxpayer is now allowed an exemption of $500 for himself, $500 for his wife, and $500 for each dependent.

Even in wartime, the extent of the reduction in exemption levels was controversial. Now that prices are high and the cost of living rising, current exemption allowances are being criticized more vigorously than ever. However, to be relied on as the most important revenue source, the individual income tax should apply to a substantial proportion of income receivers and of the national income. Necessarily, this entails personal exemptions that are low by prewar standards. In view of the importance of this entire question from both revenue and equity standpoints, re-examination of the individual income tax exemptions occupies a high position on the priority list of matters for consideration in connection with postwar tax revision.

B. Major problems and issues

1. The immediate problem

The question of exemption revision has been made more pressing as a result of increases in living costs. As measured by the Bureau of Labor Statistics Consumers' Price Index for moderate-income families in large cities, living costs have risen 64.8 percent from 1939 to September 1947. On this basis, the purchasing power of $500 has shrunk to $303 in September 1947 as compared with 1939. As a result, it would take $824 in September 1947 to buy what $500 bought in 1939. (See Chart 3.) Since 1942, when the single person's exemption was first reduced to $500, the cost of living has risen by 40.6 percent. Thus, compared with the average for 1942, the purchasing power of a $500 exemption as of September 1947 has fallen to $356. Conversely, at September 1947 consumer prices, $703 would be required to buy what $500 purchased at 1942 prices. As compared with 1944, the year of enactment of the $500 per capita exemption for surtax purposes, the cost of living has increased by 30.5 percent. Thus, compared with its 1944 buying power, the $500 exemption has shrunk to

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1/ For a tabular survey of Federal individual income tax exemptions since 1913, see Table 1, p. 55.

$383, and the current cash equivalent of the buying power of the 1944 exemption is about $653. 1/

While the ultimate postwar price outlook is uncertain, there is a presumption that prices will for some time remain substantially above prewar levels. In view of the decrease of the exemption in terms of real buying power, an upward adjustment to September 1947 prices would require a per capita exemption level of about $650 merely to restore the substantive levels prevailing in 1944, the time of enactment of the $500 per capita exemptions.

2. Specific issues in connection with postwar tax revision

Basically, the individual income tax exemptions are related to the role of the individual income tax in the revenue system as a whole and its over-all strength. The subject of exemption revision raises the following specific issues: (1) immediate adjustment of the exemptions to take account of higher living costs, (2) the postwar level of exemptions consistent with adequate revenues and the extent of reliance on the individual income tax as compared with other taxes, (3) exemption increases versus rate reductions as a means of tax relief, (4) adjustment of relative amounts of exemptions (for single persons, married couples, and dependents), and (5) the timing of exemption changes in relation to economic and fiscal conditions.

1/ Computed from Bureau of Labor Statistics Consumers' Price Index for moderate-income families in large cities (formerly known as the "cost-of-living index"). The values of this index, adjusted to 1939 as a base, are shown in Chart 2, p. iii, the latest value being 164.8 for September 1947. The computations shown above probably understate the shrinkage in the real value of the exemptions for very low-income taxpayers, since the Consumers' Price Index is weighted in accordance with the buying habits of a moderate-income family, whereas the budget of a low-income family, nearer the exemption level, would include higher proportionate expenditures on food, an item which has risen substantially more than the index as a whole.

Related questions include the following: (1) stability versus flexibility of exemptions in the postwar tax structure, (2) possible substitutes for higher exemptions, such as a low starting rate or special deductions for hardship cases, (3) the possibility of a basic change in exemption method, such as the adoption of tax credits or other devices in lieu of exemptions, and (4) the carry-forward or carry-back of unused exemptions as an averaging device.

C. Scope of study

This study is designed to bring together the available factual information with regard to the adequacy of existing exemptions, and to discuss the considerations of revenue, equity, economic effects, and compliance and administration involved in alternative methods of adjusting the exemptions. In addition, the function and purpose of individual income tax exemptions are discussed in Appendix I (pages 46 to 49).

II. Exemptions compared with essential living costs

It is common practice to appraise exemptions with reference to "essential living costs." 1/ While scientific budget data are sometimes used for this purpose, discussions of the subject commonly relate to everyday observation or illustrative consumer budgets constructed on

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1/ This viewpoint appears as far back as the beginnings of the Federal income tax, during the Civil War period. The then Commissioner of Internal Revenue stated with reference to the $600 personal exemption provided under the 1864 law: "It was, of course, the purpose of the law to exempt so much of one's income as was demanded by his actual necessities." Report of the Commissioner of Internal Revenue, 1866, p. XXIII. Consideration was given to the essential living-cost approach by the Colwyn Committee in 1920 which, in discussing income tax exemptions, noted three different income levels where taxable capacity may be held to begin: (a) minimum income necessary for bare subsistence, (b) income adequate to "equip and maintain a healthy and efficient citizen," and (c) income sufficient to provide the conventional comforts and luxuries of working people. While the Committee apparently made no precise measurement of these income levels, living costs were stated to be one of the considerations underlying its recommendations with regard to exemption levels. It is also noteworthy that the Committee recommended stable exemptions, which should be increased only when the cost of living rises significantly. See Report of the Royal Commission on the Income Tax, Great Britain, 1920, pp. 55-56, and Appendix I of the present report, pp. 46-49.

the basis of personal experience. 1/ In this section, a more systematic survey is made of the available consumer budget and expenditures data that throw light on the adequacy of exemptions.

Such data may serve as benchmarks with regard to two different but related aspects of the exemption problem: (1) exemption levels and (2) relative exemptions for different family statuses.

A summary of the more recent consumer budget and expenditure studies by various scientific, labor and governmental groups is shown in Table 2 (pages 57 to 62).

The major consumer standards which are available for appraising the level of income tax exemptions are: (1) a maintenance budget, (2) a city worker's family budget which provides for a modest but currently adequate standard of living, (3) a so-called health and decency budget, and (4) the "break-even" point as found in consumer expenditure studies, indicating where, on the average, family expenditures balance income without savings or deficit.

Family budget estimates are designed to represent the cost of a minimum list of items considered necessary to achieve a certain standard of living. They are not a perfect measure, for among other reasons, the cost of obtaining a given standard may vary considerably among families to which the budget relates on account of differences in spending and consumption habits. Thus, the number of dollars a family actually spends before reaching a particular standard may often be more than the amount stated in the estimated budget. Consumer expenditure studies, on the other hand, show what consumers spend their money for, and are not specifically related to any standard of living.

It is necessary to warn further against treating the findings below as conclusive. The fragmentary data, which are subject to revision as more up-to-date figures become available, were originally gathered for other purposes than appraising income tax exemptions. They apply only to families of specific types living in certain kinds of communities. They are therefore not perfectly applicable to all living arrangements, to all parts of the country, or to all periods of time. The budget data have been adjusted to September 1947 prices by means of the Consumers' Price Index. This type of price adjustment will produce different results than if the budgets were actually priced in September 1947, because the items and weights in the Consumers' Price Index differ from those in the several budgets.

1/ See, for example, testimony of witnesses in Revenue Revision of 1943, Hearings before the Committee on Ways and Means, House of Representatives, 78th Congress, 1st Session, pp. 942-1006.

In addition to the family budget and expenditure data, useful in appraising the level of income tax exemptions, it is also necessary to appraise the relative amounts of exemption accorded different family statuses. If it is intended to exempt from income tax a level of income estimated as necessary to obtain a certain standard of living, then the exemptions accorded families of different size need to be determined in a manner calculated to achieve the intent. For this purpose it is necessary, in the absence of separate budget studies for each family size, to have information indicating the relative amounts of income needed by families of different size to attain about the same level of living.

The most recent figures for each of the available measures for appraising the existing income tax exemptions are briefly discussed and compared in the following sections. The fragmentary data on levels of living have been extended for the various family sizes indicated by means of procedures based on data on relative incomes. The figures for relative incomes are intended to show the relative amounts needed for comparable welfare, based on savings and diet criteria, for families of different size.

A. Relative incomes needed for comparable welfare

The following table presents the relatives of the exemptions under the per capita system for families of different size, using the two-person family as a standard. It also shows the relatives of incomes estimated to yield the same standard of living among families of different size. These estimates were made by the Cost of Living Division of the Bureau of Labor Statistics from an analysis of family expenditure data.

Two criteria were selected as defining the same standard of living among different family groups: (1) the percentage of income saved and (2) the percentage of families having fair or good diets. Under the savings criterion, the levels of income regarded as providing the same standard of living for families of different size are those which on the average permit such families to save the same percentage of their incomes. Under the diet criterion, the levels of income considered to afford comparable living standards for families of different size are those which on the average result in the same percentage of families obtaining good or fair diets in each size group. 1/

1/ While it may be possible to question the validity of conclusions resting on the savings and diet factors alone without considering other aspects of family living, it might be pointed out that those familiar with such studies believe the use of other factors would not produce substantially different results inasmuch as they would probably be correlated with either savings or diet. This qualification is discussed further in Appendix II (pp. 50- 54).

Estimates of incomes of families of different size corresponding to the same standards of living, expressed as relatives of the amount for a two-person family

(two-person family = 100)

Size of family (1)	Per capita exemption (2)	Income relatives based on a/		Allowances for each additional person, as percent of amount for two-person family, based on	
		Savings criterion (3)	Diet criterion (4)	Savings criterion (5)	Diet criterion (6)
1	50 %	70 %	b/		
2	100	100	100 %	30 %	
3	150	127	129	27	29 %
4	200	151	154	24	25
5	250	172	176	21	22
6	300	191	198	19	22

a/ For detailed explanation of construction and source, see Appendix II.
b/ Not available.

The above figures for relative incomes needed for comparable welfare for different-sized families indicate relative incomes of about 7-10-2.5 for single, married, and dependent persons, respectively, as against a ratio of 5-10-5 under per capita exemptions. As against exemptions which would cover comparable living standards for families of different sizes, the per capita exemption system appears to accord relatively too little exemption to single individuals and relatively too much for dependents, taking the two-person family as a standard of reference.

B. Maintenance budget

The maintenance budget is intended to represent the minimum standard of living necessary to maintain health and efficiency of a manual worker with a family of four living in a large city. A maintenance budget for larger or smaller families is one which provides an equivalent standard of living. For the purposes of the present study the maintenance budget was based on the latest figures published by the Heller Committee for a "dependent" married couple. 1/ These figures were adjusted upward by

1/ The Heller Committee for Research in Social Economics, University of California, Quantity and Cost Budgets for Dependent Families or Children, Prices for San Francisco, September 1946. The term "dependent," as used in the Heller study, refers to persons who are supported entirely by public assistance or are supported in part publicly and in part through earnings. See Table 2, p. 58, and footnotes for details of the adjustments indicated in the text.

adding allowances for expenses of medical care, life insurance, and social security taxes which would have to be met by a self-sufficient couple. The augmented budget excludes savings (other than that included in the small amount of life insurance) and Federal income tax. 1/ The figures for the other five family statuses shown in the following table were obtained by applying the estimated income relatives (based on the diet and savings criteria) to the couple's budget. The present exemptions of $500 per capita, applicable against net income, were raised to correspond with the maximum amounts of income not subject to tax under the tax liability table which allows for a standard deduction of about 10 percent of adjusted gross income. Thus, the married wage earner with income of less than $1,125 has no income tax liability under the tax table.

The estimated budget data, being fragmentary, naturally carry the limitations applicable to the basic figure of $1,364 for a two-person family, as well as the imperfections superimposed by the statistical procedure. The chief qualification is related to the fact that the two-person family maintenance budget relies mainly on the public-welfare-standard budget of the Heller Committee. This budget applies to the San Francisco area for September 1947. 2/ In the absence of estimates having greater scope, the San Francisco figure is taken roughly to represent all urban areas.

1/ The Federal individual income tax liability is excluded, since the budget data are being used to appraise the present exemption level at which no income tax is paid.

2/ The Heller budget was priced in September 1946 and the figure for a dependent couple with employed husband was $1,242 as of that date. The price adjustment to September 1947 made here is in accordance with the statement of the Heller Committee that "although the items and weights used in the Consumers' Price Index and those in the Dependency Budget differ considerably, a very fair approximation of the increase in the cost of the Dependency Budget to any given date may be obtained by applying the increase shown in the monthly Consumers' Price Index for San Francisco since September 1946." The Heller Committee for Research in Social Economics, University of California, Quantity and Cost Budgets for Dependent Families or Children, Prices for San Francisco, September 1946, p. 6.

Comparison of present exemptions with estimated budget amounts at the maintenance level for families of different sizes a/

Size of family- (1)	Present gross exemption (2)	Estimated maintenance budgets b/ (3)	Difference c/ (4)
1	$ 550	$ 955	$ - 405
2	1,125	1,364	- 239
3	1,675	1,746	- 71
4	2,225	2,080 d/	145
5	2,775	2,373	402
6	3,350	2,653	697

a/ Estimates are based on budget data as of September 1946, adjusted by means of the Consumers' Price Index to September 1947, for consumers residing in San Francisco. (See also Table 2, p. 58, and footnotes.)

b/ Constructed from relative incomes (2-person family = 100) and Heller maintenance budget for a married couple with husband employed and with allowances added for medical care, life insurance, and social security taxes.

c/ Minus signs denote excess of budget amounts over exemptions.

d/ This figure compares with the figure of $2,136 for a 4-person family obtained independently on the basis of the Heller maintenance budget data.

According to the estimates in the table above, maintenance budgets require about $950 for a single individual, about $1,350 for a married couple, and roughly $300 to $400 for a dependent. Judged by maintenance living standards, present exemptions appear to be (a) inadequate to exempt single persons or married couples, (b) probably close to the range of adequacy for families of three and four persons, considering that the data are fragmentary and may involve relatively large errors, and (c) more than adequate for individuals entitled to at least five exemptions, with an indicated increasing margin of surplus as the number of dependents increases.

C. City worker's family budget

Recently the Bureau of Labor Statistics completed a study of costs of living in 34 large cities of the United States based on a city worker's family budget priced in March 1946 and June 1947. 1/ This budget is for a family of four persons: a man who is a city worker; his wife, a homemaker devoting her full attention to the care of the home and the children; and two children, a 13 year old high-school boy and an 8 year old grade-school girl. For this type of family, the budget is stated to represent amounts necessary to provide family health, worker efficiency, nuture of children, and social participation by all members of the family. It is descriptive of a "modest but currently adequate United States standard of living." It is neither a "minimum" nor a "luxury" budget. It is not an "ideal" budget based on the notions of a few people as to what workers should have. It is based on the kinds of goods and services workers' families actually select.

The accompanying table presents the cost of this budget in 34 cities in March 1946 and June 1947. In June 1947, the total cost of the goods and services 2/ ranged from a low of $2,734 in New Orleans, Louisiana, to a high of $3,111 in Washington, D. C. The estimated total cost of the budget 3/ ranged from a low of $3,004 in New Orleans to a high of $3,458 in the District of Columbia.

For San Francisco the total cost of goods and services was $2,964 and the estimated total cost of the budget was $3,317 in June 1947. In general, these costs are higher than the Heller maintenance budget (pages 6-8) but lower than the Heller health and decency budget (pages 12-13).

1/ See statement of Mr. Ewan Clague, Commissioner of Labor Statistics, on The City Worker's Family Budget before the Western Subcommittee of the Joint Committee on the Economic Report, December 16, 1947. For a general description of the purpose and methods followed in developing this budget see, "City Worker's Family Budget," U.S. Department of Labor, Bureau of Labor Statistics, December 1947.

2/ Includes food, housing, clothing, medical care, transportation, other goods and services such as reading and recreation, personal care, tobacco, and gifts and contributions to church and charity

3/ Includes other outlays besides goods and services such as life insurance but no other savings, occupational expenses, and poll, local, State and Federal income taxes.

CITY WORKER'S FAMILY BUDGET

TOTAL COST OF GOODS AND SERVICES WITH ESTIMATED TOTAL COST OF THE BUDGET
34 CITIES - MARCH 1946 AND JUNE 1947 1/
IN ORDER OF TOTAL COST OF GOODS AND SERVICES IN JUNE 1947

City and State	June 1947		March 1946	
	Total Cost of Goods & Services 2/	Estimated Total Cost of Budget 3/	Total Cost of Goods & Services 2/	Estimated Total Cost of Budget 3/
Washington, D. C.	$ 3,111	$ 3,458	$ 2,718	$ 2,985
Seattle, Wash.	3,054	3,388	2,660	2,913
New York, N.Y.	3,019	3,347	2,583	2,820
Milwaukee, Wisc.	2,988	3,317	2,575	2,811
Boston, Mass.	2,981	3,310	2,598	2,842
Detroit, Mich.	2,974	3,293	2,578	2,813
Pittsburgh, Pa.	2,973	3,291	2,535	2,761
Minneapolis, Minn.	2,965	3,282	2,550	2,779
Chicago, Ill.	2,965	3,282	2,561	2,793
San Francisco, Calif.	2,964	3,317	2,582	2,853
Baltimore, Md.	2,944	3,260	2,565	2,797
St. Louis, Mo.	2,928	3,247	2,580	2,824
Mobile, Ala.	2,925	3,276	2,557	2,826
Norfolk, Va.	2,919	3,241	2,563	2,804
Memphis, Tenn.	2,912	3,220	2,524	2,750
Los Angeles, Calif.	2,910	3,251	2,512	2,766
Birmingham, Ala.	2,904	3,251	2,521	2,781
Richmond, Va.	2,904	3,223	2,542	2,776
Cleveland, Ohio	2,897	3,200	2,495	2,712
Portland, Me.	2,894	3,200	2,511	2,735
Denver, Colo.	2,870	3,168	2,494	2,711
Philadelphia, Pa.	2,867	3,203	2,442	2,681
Scranton, Pa.	2,866	3,163	2,422	2,623
Savannah, Ga.	2,855	3,150	2,502	2,721
Portland, Ore.	2,854	3,161	2,521	2,748
Atlanta, Ga.	2,853	3,150	2,475	2,691
Buffalo, N.Y.	2,844	3,136	2,415	2,615
Jacksonville, Fla.	2,843	3,135	2,466	2,677
Manchester, N.H.	2,837	3,132	2,481	2,700
Cincinnati, Ohio	2,830	3,119	2,467	2,678
Indianapolis, Ind.	2,790	3,098	2,440	2,667
Houston, Texas	2,746	3,020	2,345	2,532
Kansas City, Mo.	2,739	3,010	2,405	2,603
New Orleans, La.	2,734	3,004	2,381	2,573

1/ The total dollars necessary to provide family health, worker efficiency, nuture of children, and social participation by all members of the family. For relative differences between cities, see other side of page. For description of this budget, see "City Worker's Family Budget," R. 1909, or Monthly Labor Review, February 1948.

2/ Includes food, housing, clothing, medical care, transportation, other goods and services such as reading and recreation, personal care, tobacco, and gifts and contributions to church and charity.

3/ Includes other outlays besides goods and services such as life insurance but no other savings, occupational expenses, and poll, local, State and Federal income taxes.

SOURCE: U.S. Department of Labor, Bureau of Labor Statistics, Washington 25, D. C., December 1947.

For purposes of presenting the BLS City Worker's Family Budget in the same manner as the two Heller budgets, the BLS June 1947 budget for San Francisco was modified to exclude Federal income tax and then adjusted to September 1947 prices by means of the BLS Consumers' Price Index for San Francisco. Since the City Worker's Family Budget is available only for the four-person family, the estimates for the six family statuses presented in the table below were obtained by applying the income relatives based on the diet and savings criteria to the adjusted budget figures for the four-person wage earner family.

Comparison of present exemptions with estimated city worker's family budget amounts, for families of different sizes a/

Size of family (1)	Present gross exemption (2)	Estimated city worker's family budgets b/ (3)	Differences c/ (4)
1	$ 550	$ 1,495	$ -945
2	1,125	2,136	-1,011
3	1,675	2,734	-1,059
4	2,225	3,257	-1,032
5	2,775	3,716	-941
6	3,350	4,154	-804

a/ Estimates are based on budget data as of June 1947, adjusted by means of Consumers' Price Index for September 1947, for consumers residing in San Francisco.

b/ Constructed from relative incomes (four-person family = 100) and BLS budget for city worker's family of four exclusive of Federal income tax. The estimate of $3,257 for September 1947 is 4 percent higher than the June 1947 BLS figure of $3,131 exclusive of Federal income tax.

c/ Minus signs denote excess of budget amounts over exemptions.

The estimates presented in the above table indicate that a modest but currently adequate level of living requires about $1,500 for a single person, about $2,150 for a married couple, and roughly $450 to $600 for a dependent. Judged by these estimates, present aggregate exemptions appear to be substantially below this standard of living for all sizes of family units.

D. Health and decency budget

The health and decency budgets, incorporating what is sometimes termed the American standard of living, were developed by the Heller Committee for a single person and a specified type of four-person family at various income levels (executive, white collar, and wage earner) and have been revised yearly. 1/ These budgets attempt to measure the cost of a peacetime standard of healthful and reasonably comfortable living -- a standard containing the same items as in the prewar years 1939-40-41, including all taxes, adequate medical care, recreation, and life insurance, but no other form of savings. 2/ For the purposes of the present study, the Heller budget figures for the wage earner's family have been selected. The wage earner's budget was modified to exclude Federal income tax, and then adjusted to September 1947 prices by means of the Bureau of Labor Statistics Consumers' Price Index for San Francisco. 3/

Since the health and decency figures are published only for two family sizes, a single working woman living alone and a four-person family, the estimates for the six family statuses shown in the following table were obtained by applying the income relatives based on the diet and savings criteria to the adjusted budget figures for the four-person wage earner family.

1/ The Heller Committee for Research in Social Economics, University of California, Quantity and Cost Budgets for Three Income Levels, Prices for San Francisco, September 1946, and Quantity and Cost Budget for a Single Working Woman, Prices for San Francisco, September 1946.

2/ During the recent war years the budgets were modified into wartime budgets to take into account the problems of scarcities, rationing, war bond purchases and other wartime situations. The peacetime budgets were restored beginning September 1946.

3/ Further detail is given in Table 2, p. 57.

Comparison of present exemptions with estimated budget amounts at the health and decency level, for families of different sizes a/

Size of family (1)	Present gross exemption (2)	Estimated health and decency budgets b/ (3)	Difference c/ (4)
1	$ 550	$ 1,686 d/	$ - 1,136
2	1,125	2,408	- 1,283
3	1,675	3,082	- 1,407
4	2,225	3,672	- 1,447
5	2,775	4,190	- 1,415
6	3,350	4,683	- 1,333

a/ Estimates are based on modified budget data as of September 1946, adjusted by means of the Consumers' Price Index for September 1947, for consumers residing in San Francisco. (See also Table 2, p.57 and footnotes.)

b/ Constructed from relative incomes (4-person family = 100) and Heller Committee budget for wage earner's family of four exclusive of Federal income tax.

c/ Minus signs denote excess of budget amounts over exemptions.

d/ This figure compares with the figure of $1,910 for a single working woman obtained independently on the basis of the Heller Committee budget studies.

The estimates presented in the above table indicate that health and decency levels require about $1,700 for a single individual, about $2,400 for a married couple, and roughly $500 to $650 for a dependent. Judged by these estimates present aggregate exemptions appear to be substantially below the health and decency level for all sizes of family units.

E. "Break-even" points

A useful expenditure-level concept is the "break-even" level. The break-even level is the point in the income scale where families, on the average, neither save nor go into debt. Below the break-even level, families typically fall back on their past savings or borrow in order to meet expenses. Above the break-even level families, on the average, manage to save part of their income. The break-even point is computed from data showing actual expenditures and savings for large groups of families with different incomes. Unlike the other budget concepts referred to above, it does not represent a specifically defined level of living arrived at by adding up the total cost of a number of selected consumption items.

In appraising income tax exemptions, the break-even level may serve as a benchmark from both economic and equity standpoints. Thus, the break-even point is significant in indicating the income levels where taxation would have a heavy impact on consumer spending. Equity-wise, the break-even level is important because it may be regarded as unfair to tax individuals whose incomes are such that they are unable to save or are compelled to use past savings or go into debt. 1/

In 1944 the income level of the break-even point was higher than the amount of the maintenance budget and lower than the amount of the health and decency budget, indicating that, on the average, savings do not appear until family income is substantially above the minimum amount given by maintenance requirements. (See Table 2, pages 57-59.) This may be taken to throw light both on the average willingness to save and on the stringency of the maintenance budget concept. However, it cannot be concluded that families at the break-even level live at a maintenance or any other specific standard of adequacy, since as previously indicated, the actual plane of living of a family depends not only upon the amount of income but also upon the way such income is spent and the goods purchased are utilized.

The following table shows estimated 1944 break-even points for six-family statuses. These were determined by applying to the break-even point for a married couple, as obtained from the actual expenditures data, the income relatives based on the savings criterion. In a sense break-even data are more complete than the budget data in that they can be obtained for more sizes of family and represent the average for all family types in all large cities. However, the information tends to be unrepresentative for the larger family sizes because of the large sampling fluctuations inherent in this type of data when obtained from small-scale surveys. For this reason the break-even points for five family sizes (that is, other than the two-person family for which the data are considered to be representative) were determined by the use of income relatives.

1/ Where an individual who is using past savings is required to pay income tax, he is inclined to feel that he is paying the tax out of capital and not income. If he must borrow to pay the tax, he is even more inclined to feel that the tax is unduly burdensome.

The break-even points for 1944 have not been adjusted to September 1947 on the basis of the over-all price index adjustment used to inflate the budget data discussed above. Such an adjustment procedure in connection with the break-even point would not be valid since the relationship between changes in prices and in the actual break-even level probably would not be as simple as the adjustment might imply. 1/ The break-even point varies with changes in the families' actual expenditure habits and response to relative price changes which are not reflected in the price index. Moreover, the break-even level may also depend on such other factors as the presence of liquid assets, and the optimistic or pessimistic economic and employment outlook.

Comparison of present exemptions with break-even points for 1944 for families of different sizes a/

Size of family: (1)	Present gross exemptions (2)	Break-even points given by relative incomes (2-person family = 100) b/ (3)	Difference c/ (4)
1	$ 550	$ 1,045	$ - 495
2	1,125	1,493	- 368
3	1,675	1,896	- 221
4	2,225	2,254	- 29
5	2,775	2,568	207
6	3,350	2,852	498

a/ The break-even figure for a 2-person family is determined from the 1944 survey of civilian spending and saving conducted by the Bureau of Labor Statistics. The figures for other sizes of families are obtained by applying the income relatives based on the savings criterion. The figures based on income relatives vary to some extent from the independently determined figures computed from the survey of consumer expenditures in 1944 shown in Table 2, p. 59, but are regarded as more suitable for present purposes because of the large sampling fluctuations inherent in survey data relating to families larger than the average size.

b/ Family money income net of income, poll, and personal property taxes.

c/ Minus signs denote excess of break-even points over exemptions.

1/ Thus, if the result of adjusting 1941 data to 1944 by a price index is compared with actual changes in the break-even levels for families of different sizes, considerable differences arise. From 1941 to 1944, the increase in the break-even point varied from 1 percent for 2-person families to over 80 percent for 5-person families, whereas the Bureau of Labor Statistics Consumers' Price Index increased by 19 percent in that period. (See Table 2, p. 59, for 1941 and 1944 break-even points.)

With reference to 1944 break-even levels, exemptions appeared to be inadequate for families of less than four members and exceeded the break-even levels for families of five or more. The $29 deficiency for the four-person family in 1944 is probably within the area of error and should not be regarded as significant. Rough adjustments to these break-even levels for price increases suggest that, at September 1947 prices, the break-even levels probably exceed present exemptions for all sizes of family units.

F. Difficulties in relating exemptions to essential living costs

Assuming agreement on the principle that it is desirable to exempt some minimum living standard, a number of conceptual and practical difficulties are involved in its application. While not exhaustive the following list indicates the more important of such difficulties:

(1) Minimum living standard concepts are elastic. Any acceptable concept would probably be far above a bare physiological minimum. That is, modern concepts of living needs do not always permit a clear-cut distinction among necessities, amenities, and luxuries.

(2) Important differences apparently exist in the range of living costs and certain of the requirements even when comparisons are made among large cities. For example, the accompanying table shows that the relative difference in total cost of goods and services included in the Bureau of Labor Statistics' City Worker's Family Budget ranged 12 percent, or from 88 in New Orleans, Louisiana to 100 in Washington, D.C. The cost of housing is particularly important in accounting for differences in the costs of living among these cities. Thus, the relative difference in the cost of housing ranged 35 percent, or from 65 in New Orleans to 100 in Washington, D. C. When the 3 highest cost cities and the 3 lowest cost cities are excluded from the range of living costs, the relative difference in the total cost of goods and services is reduced by about one-half.

(3) Different taxpayer groups enjoy varying amounts of real or non-cash income that is not taxable, such as the rental value of owner-occupied homes and home-grown foods. A uniform exemption does not decrease these disparities between families of the same size, as for example, between rural home-owner and urban tenant, and consequently, an exemption of a given dollar amount may relieve from tax substantially different real living standards. Moreover, issues are also raised with respect to the varying amount of nontaxable real income between families of different size. For example, the income relatives indicate that a single person requires about two-thirds the income of a married couple to attain the same standard of living. The contribution of a substantial

CITY WORKER'S FAMILY BUDGET

RELATIVE DIFFERENCES IN THE COST OF GOODS, RENTS AND SERVICES
34 CITIES, JUNE 1947 AND MARCH 1946
Washington, D. C. = 100

City and State	Total Cost of Goods & Services		Food		Clothing		Housing		Other	
	June 1947	Mar. 1946	June 1947	Mar. 1946	June 1947	Mar. 1946	June 1947	Mar. 1946	June 1947	Mar. 1946
Atlanta, Ga.	92	91	100	100	90	91	82	81	92	93
Baltimore, Md.	95	94	101	101	90	94	89	88	95	95
Birmingham, Ala.	93	93	102	102	92	87	81	80	97	101
Boston, Mass.	96	96	102	105	91	89	85	84	102	104
Buffalo, N. Y.	91	89	100	102	94	90	77	71	95	95
Chicago, Ill.	95	94	101	102	98	94	91	91	91	90
Cincinnati, Ohio	91	91	96	98	96	95	79	79	94	94
Cleveland, Ohio	93	92	101	100	99	98	77	76	98	98
Denver, Colo.	92	92	100	100	94	95	79	78	96	96
Detroit, Mich.	96	95	102	102	96	94	82	81	103	105
Houston, Tex.	88	86	99	100	87	81	73	70	93	94
Indianapolis, Ind.	90	90	97	99	89	89	77	78	94	94
Jacksonville, Fla.	91	91	100	102	90	84	77	77	98	99
Kansas City, Mo.	88	88	98	100	89	89	70	71	94	97
Los Angeles, Calif.	94	92	101	102	92	87	75	75	106	107
Manchester, N. H.	91	91	102	103	89	92	77	76	94	96
Memphis, Tenn.	94	93	101	101	92	89	84	83	96	98
Milwaukee, Wis.	96	95	99	99	100	93	88	87	99	100
Minneapolis, Minn.	95	94	99	99	103	97	89	87	93	94
Mobile, Ala.	94	94	101	105	90	84	89	87	93	96
New Orleans, La.	88	88	102	104	92	89	65	65	93	95
New York, N. Y.	97	95	105	105	102	97	90	91	90	86
Norfolk, Va.	92	94	101	102	94	93	81	81	99	102
Philadelphia, Pa.	92	90	102	103	94	92	79	77	93	90
Pittsburgh, Pa.	96	93	102	101	98	94	82	82	100	97
Portland, Maine	93	92	103	104	90	91	82	80	95	95
Portland, Ore.	92	93	98	101	90	94	77	75	100	104
Richmond, Va.	93	94	98	100	90	87	89	89	94	96
St. Louis, Mo.	94	95	100	101	91	90	88	88	96	99
San Francisco, Calif.	95	95	102	103	97	93	78	79	105	106
Savannah, Ga.	92	92	102	102	85	87	83	83	93	94
Scranton, Pa.	92	89	101	101	98	88	76	75	95	94
Seattle, Wash.	98	98	105	106	99	99	84	81	105	108
Washington, D. C.	100	100	100	100	100	100	100	100	100	100

SOURCE: "City Worker's Family Budget," U. S. Department of Labor, Bureau of Labor Statistics, Washington 25, D. C., December 1947, Table 2, p. 40.

amount of real income which usually is made by the housewife to the family is an important reason why the couple does not need twice the money income of a single person to attain the same standard of living. Since the income tax applies primarily to money incomes, the use of the above ratio to determine the relative amounts of exemption accorded single persons and married couples would seem to involve taxing the real income added by the housewife.

(4) Particularly in the case of single individuals with no dependents, minimum living costs will vary, for example, as among (a) older persons maintaining separate households and (b) younger persons living in the parental home and sharing expenses with a family group. As already indicated, the amount of money income needed by families to attain the same level of living will also vary depending on whether the housewife works at home or is gainfully employed.

Under the circumstances, given the exclusion of certain types of non-money income from the tax base and the practical necessity of applying exemptions on a uniform, nation-wide basis, it is necessary to choose (with respect to a given size of family) between a lower exemption which will bear somewhat heavily on high living-cost groups and a higher exemption which will lose more revenue, or to strike some average. It is also necessary to use the income relatives with caution in considering the amounts of relative exemption which would appear to give comparable standard of living exemptions to families of different size.

III. Other considerations respecting exemption levels

A. Revenue considerations

Revenue need is another important factor which must be weighed in the balance along with standard of living considerations in determining the desirable level of exemptions. In this connection it should be noted that relatively moderate changes in the level of exemptions produce substantial changes in the revenue yield of the individual income tax.

1. Exemptions of $600 per capita

It is estimated, assuming present law rates and income payments of $166 billion, that an increase in exemptions from $500 to $600 per capita would reduce individual income tax revenues by about $1.65 billion in calendar 1947, or almost 10 percent. Under exemptions of $600 per capita, the number of individual income taxpayers would be about 44 million, or about 4.7 million less than under present law, a reduction of about 10 percent. The surtax net income base would be reduced to $60.8 billion, or $8.3 billion less than under present law, amounting to a 12-percent reduction.

2. Exemptions of $700 per capita

Similarly, an increase in exemptions from $500 to $700 per capita is estimated to decrease individual income tax revenues by about $3.03 billion or about 18 percent. At this higher level of exemptions, the number of individual income taxpayers would be about 38 million, a reduction of about 10.5 million, or 22 percent, from present law. The surtax net income base would be reduced to about $54 billion, or $15.3 billion below present law, amounting to a 22-percent reduction.

A summary of estimated revenue yield, surtax net income base, and number of taxable income recipients is shown in the accompanying table for the three exemption levels of $500 per capita, $600 per capita, and $700 per capita. 1/

3. Comparison of revenue effects of exemption and rate changes

With an estimated 1947 surtax net income base of $69.1 billion under present law, a $100 increase in exemptions on the per capita basis would be equivalent revenue-wise to a reduction of about 2.4 percentage points in the combined normal and surtax rate applicable to each bracket. A $200 increase in per capita exemptions would equal a reduction of 4.4 percentage points in the combined rate scale in all brackets. The distribution of the reduction under these alternative rate reductions would, of course, be quite different than under the indicated exemption increases. This results from the fact that low-income taxpayers would have their taxes considerably reduced or even entirely eliminated under exemption increases, whereas the rate reductions would not give so great a decrease and would not remove anyone from the tax rolls. Thus, the $200 per capita exemption increase would remove the tax on a married couple with $1,400 net income, whereas the 4.4-point rate decrease would still leave the couple with about three-fourths of its present tax liability. On the other hand, a couple with $100,000 of net income would have a reduction of $331 under the $200 exemption increase as compared with more than $4,000 under the 4.4-point rate decrease.

1/ See also Chart 5 and Table 3 of this study (pp. x, and 63-64).

Estimated number of taxable income recipients, their surtax net income and combined normal tax and surtax under three per capita exemption levels, in calendar year 1947

(assuming income payments of $166 billion) 1/

Exemptions			Taxable income recipients			Surtax net income			Combined normal tax and surtax		
Single person	Married couple	Dependents	Number	Decrease from present law		Amount	Decrease from present law		Amount	Decrease from present law	
				Number	Percent		Amount	Percent		Amount	Percent
(number of income recipients in thousands; money amounts in millions)											
$500	$1,000 (present law 2/)	$500	48,544.6	-	-	$69,114.3	-	-	$16,692.0	-	-
600	1,200	600	43,816.7	4,727.9	9.7%	60,820.9	$8,293.4	12.0%	15,046.1	$1,645.9	9.9%
700	1,400	700	38,017.0	10,527.6	21.7	53,851.7	15,262.6	22.1	13,658.3	3,033.7	18.2

Source: Office of the Technical Staff, Treasury Department.

1/ The definition of income payments used here is the unrevised concept. See "National Income Supplement to Survey of Current Business," July 1947. The current level of income payments is substantially higher than the $166 billion level assumed when these estimates were prepared. The higher level of income payments would appreciably raise the amounts of the revenue losses involved, but the percentages of the revenue losses to the total tax liability would not be changed appreciably. The estimated decreases in the number of taxable income recipients would also be noticeably larger.

2/ Internal Revenue Code, as amended by the Revenue Act of 1945.

B. Economic considerations

1. Consumer markets

Higher personal exemptions, at a time of actual or threatening deflation, would tend to bolster consumer markets. Conversely, when inflation is active or threatens, lower exemptions tend to reduce inflationary spending pressures. From the long-run standpoint, the level of exemptions should be considered in the light of the requirements of mass buying power essential to industrial prosperity.

2. Incentives

In terms of over-all revenue goals, higher exemptions and lower rates are competing alternatives. In the nature of the problem, the upward adjustment of exemptions, therefore, means a sacrifice of tax rate relief for economic incentive purposes.

An increase in exemptions would give the greatest relative amount of tax relief to the lower income taxpayers. Not much would be directly gained incentive-wise from exemption increases. However, indirectly, by increasing the demand of the mass of income taxpayers for goods and services and providing more profitable business opportunities, upward adjustment of the exemptions would tend to stimulate work and investment incentives.

From the economic incentive standpoint, the alternative to an exemption increase is a general rate reduction, especially in the middle and upper surtax areas where incentives to work and invest are stated to be most affected by the existing income tax rates. In this connection, it is pointed out that substantial rate reductions for upper income taxpayers involve relatively small revenue reductions under the individual income tax. However, as already indicated above, even moderate increases in exemptions have substantial effects on the revenues. Consequently, a greater direct incentive effect can probably be obtained from rate reductions than from exemption increases, assuming the same amount of revenue loss.

3. Shifting of income tax

While as a general rule the individual income tax probably is not shifted in the form of higher wage rates, there may be important exceptions. Thus, the income tax may, under some circumstances, encourage increased wage demands and, in this connection, an upward revision of the exemption level would tend to dampen demands for wage-rate increases. Somewhat similar results might be expected under a reduction in tax rates, although differences in the distribution of tax relief under the exemption method as compared with tax rate changes might be important as regards the labor market.

C. Administration and compliance

Administrative and compliance factors have always been considered with a view to fixing exemptions above the point where collection costs would be excessive in relation to revenue returns. To some extent the administrative outlook on exemptions has been modified by the wartime experience. The initial difficulties in applying the individual income tax on a mass basis have been largely surmounted through current methods of tax payment, namely withholding of tax from wages, and simplified methods of filing tax returns. Nevertheless, a considerable area of compliance and administrative problems remains with respect to farmers, business proprietors, and other self-employed people which would be narrowed by higher exemptions. Moreover, the administration of the W-2 return system, including computation of tax by the Bureau and resulting bills and refunds to taxpayers, entail an administrative load which would be measurably lightened if exemptions were increased. Release of Bureau facilities from a portion of these tasks would permit more effective administration of a smaller number of returns. 1/ By contrast, a reduction in tax rates would not offer the immediate administrative advantages of a higher exemption level.

D. The broad base concept

Low exemptions are frequently urged to retain a broad base. The objectives of the broad base may include any or all of the following: (1) wider tax consciousness, (2) de-emphasis of hidden taxes or business taxes, (3) lower individual rates, and (4) preservation of the revenue potential and administrative machinery for use as the need may arise.

E. Relationship of exemptions to deductions and exclusions

Certain personal deduction allowances, such as those for interest on personal indebtedness on home mortgages and charitable contributions, may serve to remove from the tax base personal expenditures incurred to some extent by large numbers of taxpayers. Among other effects, such deductions may tend to supplement the personal exemptions in protecting some minimum living standard from income tax, but are limited to taxpayers in a position to claim them. The optional 10-percent standard deduction which imputes a quota of such deductions to everyone automatically raises the effective minimum of income subject to tax.

1/ It should also be noted that while the wartime experience has demonstrated that the income tax can be satisfactorily administered without disproportionate collection costs on a long-range basis at very low exemption levels, substantial shifts in exemption levels over the short-run, entailing re-education of taxpayers and re-adaptation of Bureau and employer facilities, would be disadvantageous from the administrative standpoint.

Deductions like the unusual medical expense deduction provided under present Federal law are designed to relieve a comparatively few hardship cases. Such deductions are not as effective a substitute for higher exemptions as the standard deduction, because of the high degree of variation of these expenses among different individuals. However, they serve to make increased burdens due to lower exemptions (or higher rates) more tolerable.

In this connection, it is also interesting to note that under present law a dependent's gross income up to $500 is disregarded for income tax purposes. This exclusion tends to raise the level of family income which is free of tax, in the case of families where children or other dependents have relatively small amounts of income.

F. Excise taxation

In view of their impact on low-income taxpayers, the Federal excises and personal income tax exemptions are closely related. While consumers have some option with regard to their share of excise burdens by adjusting their purchases of taxed commodities, some Federal excise tax is included in the average consumer's budget. Moreover, Federal excises which are not business expenses are not deductible by individuals. Consequently, higher income tax exemptions and reduction of the excises may be considered as alternative methods of relieving low-income taxpayers. Some regard a substantial excise program as a permanent part of the postwar tax structure, serving to take part of the load off individual and business incomes. Others consider the incidence of the excises unfair as between high- and low-income recipients and arbitrary as between consumers with the same income but different choice of expenditures. They also consider the excises damaging to consumer markets and favor early reduction or repeal. 1/ On the basis of the latter viewpoint, a higher (or equally high) priority may be attached to excise reduction as compared with higher personal exemptions.

Irrespective of the merits of the existing excise taxes, there is the possibility that, in the absence of an adequate revenue margin available for tax relief, higher personal income tax exemptions may tend to induce still heavier reliance on excise or sales taxes. Moreover, once increased, it may be difficult to lower exemptions as subsequent revenue needs arise. Such circumstances might necessarily call for additional indirect tax revenues.

1/ With the possible exception of the tobacco and liquor taxes which have an important impact on low-income taxpayers but which are often thought to be in a special category because of their sumptuary aspects.

G. International comparisons 1/

1. Canada

The present Federal income tax exemptions of $500 for single persons and $1,000 for married couples are lower than the Canadian exemptions of $750 for single persons and $1,500 for married couples, effective beginning with 1947. 2/ The $500 dependent exemption under existing Federal law is higher than the Canadian, which provides $300 for dependents not eligible for family allowances and $100 for dependents eligible for family allowances. However, taking account of family allowance payments, 3/ the difference in net position of the average Canadian taxpayer with dependent children as compared with one without such dependents is closer to that in the United States than indicated by the nominal amounts of exemption.

2. United Kingdom

Under British income tax law for income years 1942-1946, the personal allowances were $320 4/ for single persons (subject to the limitation that incomes under $440 were not subject to tax), $560 for married couples, and $200 for dependents. 5/ Beginning with the 1946-1947 taxable year the British allowances were raised to $440 for single persons (the minimum income subject to tax being raised to $480) and $720 for married couples, the dependent allowance was raised to $240 for 1947-1948. Family payments also help the net position of the taxpayer with two or more dependent children. 6/

1/ See Tables 4 to 4c (pp. 65-72) for comparison of tax burdens under present law in the United States, United Kingdom and Canada.

2/ For the years 1945-1946 the Canadian exemption was $660 for a single person and an effective $1,200 for married couples, with a tax credit up to $108 for each dependent, subject to partial or complete offset where family allowance was received.

3/ Family allowance payments average about $72 annually per child under 16.

4/ British income figures are converted at the rate of £1 = $4.

5/ The increase in tax attributable to the reduction in the personal allowances from prewar levels of $400 for single persons and $680 for married couples was treated as a refundable forced savings.

6/ Since August 1946 a family allowance of $1 a week or $52 a year is paid for each child, other than the eldest, under 16 years of age.

H. Special problems

1. Fixed income and other special groups

The economic position of various special groups, such as annuitants or other recipients of low, fixed incomes, elderly or handicapped persons, and related groups, for example teachers, is also a factor to be considered in connection with the desirable level of income tax exemptions. The major problem raised by these groups stems from the double pressure of higher prices and taxes on low, relatively fixed, money incomes. Other problems may arise with regard to special personal expenses connected with age or infirmity, or difficulties of economic readjustment in the case of veterans. One phase of the problem arises from the fact that many such persons are entitled only to the relatively low exemption of $500 or $1,000 allowed to single persons or married couples without dependents.

Various types of proposals have been made for special additional exemptions applicable to the aged and other particular groups. One approach is to provide a special exemption based on age. An important example of this approach is the provision under H. R. 1, 80th Congress, First Session, for a $500 exemption for persons over 65. 1/ Another approach is the method of special exclusions applicable to pension or annuity income. 2/ Still other proposals would provide special income tax treatment applicable to the civilian income of veterans. Proposals have also been advanced which would relate special tax relief to the individual's occupational status, for example, by providing higher exemptions against school teachers' salaries.

Special relief for particular groups tends to be contrary to the general principle that the income tax should apply uniformly among similarly situated persons. To grant relief on a special-group basis in each instance makes it increasingly less defensible to deny it to other groups pressing for favorable tax treatment. The consequence of the riddling of the income tax with special exemptions would

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1/ See the Treasury tax study, "The Income Tax Treatment of Pensions and Annuities," December 1947, pp. 21-23.

2/ Ibid., pp. 20-21.

be to make it a less effective and less equitable revenue instrument. Moreover, as a means of providing special benefits to particular groups, the income tax exemption method is subject to a number of defects. Such benefits would not be distributed in accordance with need. No benefit would be provided for persons with incomes already so low they are not subject to tax. Among persons deriving some benefit from the tax exemption, the benefit would be greater the larger the individual's income. The largest benefit would go to persons with the least need.

To a considerable extent, the special-group problems mentioned here would automatically be reduced if personal exemptions generally were raised. The adjustment of generally applicable exemption levels would involve greater immediate revenue loss than special relief measures, but would not entail their objectionable equity features. Thus, an increase in exemptions would provide relief for low-income annuitants and would tend to minimize, but not solve, unsatisfactory aspects of the present income tax treatment of pensions and annuities which have been magnified by the present low personal exemptions. These difficulties include inequalities arising from the exemption of certain classes of payments such as Railroad Retirement and Social Security old-age and survivors' insurance benefits, as well as defects in the present method of allowing for the tax-free recovery of the capital element in annuities. It would also help to decrease demands for the creation of further exempt classes of pensions and annuities as well as facilitate covering Railroad Retirement and Social Security old-age benefits into the tax base, as already recommended by the Treasury Department. 1/

2. Averaging

A more liberal exemption allowance is sometimes urged in lieu of averaging for low incomes. The wastage of personal exemption in years of low income is one aspect of the penalty imposed on fluctuating as compared with stable incomes under a progressive income tax. Methods of assuring full use of the exemption, including averaging and carry-over provisions, may be viewed as liberalizing the exemption allowances. Among the methods which have been suggested is the proposal by the CIO and other labor groups for a two-year carry-forward and two-year carry-back of unused exemptions. 2/

1/ Ibid., pp. 42-45.

2/ See Revenue Act of 1945, Hearings before the Committee on Finance, 79th Cong., 1st Sess., on H.R. 4309, pp. 106, 125, and 250. The 2-year carry-forward and 2-year carry-back of unused personal exemptions was made the subject of a bill, S. 2508, 79th Cong., 2nd Sess., introduced August 2, 1946, by Senator Taylor.

As a partial substitute for the carry-over of unused exemptions, a higher exemption level would tend to reduce the scope and intensity of the averaging problem for low-income recipients in the sense that it would drop from the tax rolls low-income taxpayers whose incomes, while variable, were below the higher exemption level in every year. For the remaining taxpayers with low, variable incomes it would result in less tax in the peak income years. Consequently, such taxpayers would tend to be in a better position to maintain a minimum standard of living over a period of high- and low-income years.

In contrast with the carry-over of unused exemptions, higher exemptions would provide relatively more relief for recipients of stable incomes than for those with fluctuating incomes. Moreover, in some respects higher personal exemptions would aggravate the averaging problem since the potential loss to the taxpayer due to wastage of exemption in low-income years would be greater. 1/

I. Revenue flexibility

How should the level of personal exemptions be adjusted under conditions of boom and depression? If exemptions and rates are kept constant, the yield of the income tax will automatically increase or decrease in response to increases or decreases in the national income, thereby tending to adjust itself to the community's changing capacity to pay. 2/ This automatic revenue flexibility is frequently regarded as desirable to help check inflation or deflation. 3/

Automatic or built-in flexibility could be increased by provision for the carry-back of unused personal exemptions. Under such a provision, individuals whose incomes or wages were reduced below their exemption levels, because of a slump in business conditions, could apply for tax refunds. It is held that this kind of tax reduction would be equitable because it would single out for relief people whose needs were greatest, and at the same time put the money in the hands of those who would spend it promptly, thus helping to check the slump. To be most effective, refunds resulting from the carry-back would have to be paid promptly. 4/ Substantial delay in such payments would result in their being less helpful in attacking the deflationary forces at a relatively early stage of development. At worst, delay might result in

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1/ The problems and issues respecting the averaging of incomes under the individual income tax will be the subject of a forthcoming Treasury tax study.

2/ Such yield variations are due to two factors: (1) as incomes increase taxpayers are added to the rolls while as incomes decrease taxpayers are dropped from the rolls and (2) the tax payments of existing taxpayers are increased as incomes rise and decreased as incomes fall.

3/ See, e.g., Public Finance and Employment, Postwar Economic Studies No. 3, Board of Governors of the Federal Reserve System, pp. 41-43, and Taxes and the Budget: A Program for Prosperity in a Free Economy, Committee for Economic Development, Nov. 1947, pp. 29-30.

4/ To some extent individuals might utilize expected refunds immediately regardless of delay in actual payment by use of savings or consumer credit in anticipation of payment.

refunds being inappropriately timed in relation to changing economic conditions. The point has also been made that the carry-back of unused exemptions, unlike a carry-forward, would not weaken the tax system, since it would leave rates and exemptions to apply with full force when prosperity returned. Perhaps the strongest criticism of unused exemption carry-overs is the great compliance and administrative difficulties, the potentially large revenue losses involved, and the fact that averaging would not be provided for higher-income taxpayers whose incomes never fall below their exemption allowances. 1/

It has also been suggested that countercyclical changes in revenue be obtained by raising exemptions to combat slumps and decreasing exemptions during periods of actual or threatening inflation. This type of proposal is also open to a number of objections. (1) Taking taxpayers on and off the rolls by means of varying the exemptions would sharply raise and lower administrative peak-load requirements and necessitate taxpayer re-education to changing exemptions and, possibly, changing filing requirements. (2) Once exemptions were increased, it would tend to be difficult to lower them again as revenue needs increased. (3) General exemption changes would not be as selective as would a carry-back of unused exemptions. Higher exemptions during depression would not help the unemployed or other groups whose reductions in income were so severe as to take them off the tax rolls anyway. These groups are the ones who would most need and be most likely to use the tax refunds. (4) Increasing exemptions when national income is low, and decreasing them when national income is high would intensify the averaging problem by increasing the taxes imposed on those with fluctuating incomes compared with the taxes paid by those with stable incomes. (5) A reduction in exemptions in boom times, when the cost of living would probably be higher, would seem to be harsh on persons with low, fixed incomes. Moreover, it might not be acceptable to persons who, after being unemployed or on reduced incomes during the slump, would find their taxes increased just when they were in a position to return to a more normal income level.

1/ In contrast with the carry-back, the carry-forward of unused exemptions would tend to reduce tax yields as the economy swung into a recovery period and might even carry forward into the boom years. This would tend to make it more difficult to collect additional revenue to reduce debt at a time when the economy could best afford to make payments on the national debt. It might also reduce the effectiveness of the income tax in checking inflationary forces under boom conditions.

Variation in rates to provide added flexibility also has important limitations. The view has been expressed that low tax rates during depression periods would not readily encourage new investment, particularly if the policy of increasing rates during boom times is known to potential investors. Moreover, substantial variation in tax rates may be a disturbing factor in the investor's outlook which would tend to lead to a lower total of investment rather than a beneficial change in the timing.

From the standpoint of encouraging (or curbing) consumer buying, exemption changes would concentrate more effectively than rate adjustments the tax changes at the lower end of the income scale where a high proportion of income after taxes is customarily spent. However, neither a decrease in tax rates nor increase in exemptions would be effective in increasing the disposable income of those whose incomes dropped below taxable levels. Tax relief is probably most effective in increasing the spending of persons with impaired income, who would in the short-run be strongly inclined to use additional funds to resist curtailment of their established living standards. Thus, to the extent a tax reduction applied to persons whose incomes were not impaired by depression conditions, it would be less likely to be used for spending on consumer goods. Moreover, rate and exemption changes might be relatively ineffective in the short-run in inducing the mass of consumers to increase or decrease their expenditures in response to decreases or increases in taxes, if higher taxes were largely offset or cushioned by the use of savings or consumer credit, or tax decreases used to pay off debt or increase savings.

IV. Per capita versus differential exemptions

A. The issue

A major question in connection with exemption revision is whether an upward adjustment should be made on a straight per capita basis or whether a relatively larger increase should be made for the taxpayer and his spouse than for dependents. A subsidiary question is what type of differential, if any, should be provided in the exemption for principals 1/ as compared with dependents.

Departure from the present type of per capita exemption system would necessarily involve considerable loss of simplification. However, a greater exemption for principals than for dependents would provide relief where it appears to be most needed 2/ with a minimum sacrifice of revenue.

1/ That is, the taxpayer and his spouse.
2/ As indicated by the relative incomes needed to attain a comparable living standard for different-sized families and other consumer budget data presented above (p. 6).

While per capita exemptions are to be preferred on grounds of administrative simplicity, they would involve increasingly great sacrifice of revenue and equity the higher exemptions were raised on a per capita basis. Thus, exemptions of $800 per capita, assuming present prices, 1/ would probably involve very considerable disparity in favor of large families which might be regarded as justifying a revision of the structure even at the expense of some complication. 2/ However, at levels of $600 per capita, the equity, revenue, and simplification considerations relating to choice of exemption method are more closely balanced.

B. Considerations involved

The per capita system affords maximum simplification of administration and compliance for both the Bureau of Internal Revenue and the taxpayer. Departure from the per capita plan would inevitably involve additional complications. However, a considerable part of the present simplified system could be maintained under certain types of differential exemptions. These are described and compared with per capita exemptions on the basis of revenue, equity, and administration in the following sections.

Under per capita exemptions the single, married, and dependent exemptions are in the ratio 1-2-1. Illustrations: $500-$1,000-$500, $600-$1,200-$600, and $700-$1,400-$700.

Under differential Combination A the single-married-dependent exemption ratio would be 2-4-1. Illustrations: $800-$1,600-$400, $900-$1,800-$450, and $1,000-$2,000-$500.

Under differential Combination B, the single-married-dependent exemption ratio would be 2-3-1. Illustrations: $800-$1,200-$400, $900-$1,350-$450, and $1,000-$1,500-$500.

1. Revenue and number of taxpayers

The accompanying table shows the estimated number of income recipients, their surtax net income and combined normal tax and surtax under various per capita and differential exemption levels for calendar year 1947, assuming income payments of $166 billion.

1/ To the extent prices and money incomes generally were higher, exemptions could be increased on a per capita basis without changing the existing exemption situation in substance.

2/ As exemptions are increased the number of taxpayers decrease and, consequently, compliance and administrative problems tend automatically to decrease. This occurs not only because of the reduction in the number of taxpayers but also because the remaining taxpayers are apparently more familiar with the handling of records and instructions such as are involved in tax returns.

Estimated number of taxable income recipients, their surtax net income and combined normal tax and surtax under various exemptions, in calendar year 1947

(assuming income payments of $166 billion) 1/

Exemptions: Single person	Exemptions: Married couple	Exemptions: Dependents	Taxable income recipients: Number	Taxable income recipients: Decrease from present law: Number	Taxable income recipients: Decrease from present law: Percent	Surtax net income: Amount	Surtax net income: Decrease from present law: Amount	Surtax net income: Decrease from present law: Percent	Combined normal tax and surtax: Amount	Combined normal tax and surtax: Decrease from present law: Amount	Combined normal tax and surtax: Decrease from present law: Percent
		(number of income recipients in thousands; money amounts in millions)									
$ 500	$1,000	$500 (present law 2/)	48,544.6	-	-	$69,114.3	-	-	$16,692.0	-	-
600	1,200	600	43,816.7	4,727.9	9.7%	60,820.9	$8,293.4	12.0%	15,046.1	$1,645.9	9.9%
700	1,400	700	38,017.0	10,527.6	21.7	53,851.7	15,262.6	22.1	13,658.3	3,033.7	18.2
800	1,200	400 3/	44,476.0	4,068.6	8.4	61,350.5	7,763.8	11.2	15,161.1	1,530.9	9.2
800	1,600	400 4/	39,491.6	9,053.0	18.6	52,329.1	16,785.2	24.3	13,383.2	3,308.8	19.8
1,000	1,500	500 3/	37,396.2	11,148.4	23.0	50,434.7	18,679.6	27.0	12,991.9	3,700.1	22.2
1,000	2,000	500 4/	29,803.2	18,741.4	38.6	41,771.8	27,342.5	39.6	11,280.6	5,411.4	32.4

Source: Office of the Technical Staff, Treasury Department.

1/ The definition of income payments used here is the unrevised concept. See "National Income Supplement to Survey of Current Business," July 1947. The current level of income payments is substantially higher than the $166 billion level assumed when these estimates were prepared. The higher level of income payments would appreciably raise the amounts of the revenue losses involved, but the percentages of the revenue losses to the total tax liability would not be changed appreciably. The estimated decreases in the number of taxable income recipients would also be noticeably larger.

2/ Internal Revenue Code, as amended by the Revenue Act of 1945.

3/ Assuming that married persons filing separate returns would split their exemptions or that one spouse takes the exemption for a single person and the other the exemption for a dependent.

4/ Assuming the first dependent of a single person would qualify the single person as head of family entitled to a married couple's exemption.

As indicated in the table, exemptions of $600 per capita and differential Combination B, $800-$1,200-$400, would have roughly the same revenue effect. The former is estimated to reduce revenue by about $1.6 billion, the latter by $1.5 billion. Exemptions of $600 per capita would decrease the number of taxpayers by 4.7 million or 10 percent, while Combination B would reduce the number by 4.1 million or about 8 percent.

Similarly, exemptions of $700 per capita and differential Combination A, $800-$1,600-$400, involve roughly the same magnitude of revenue reduction. The former would reduce individual income tax liabilities by about $3.0 billion or 18 percent; the latter, $3.3 billion or about 20 percent. The per capita system would reduce the number of taxpayers by about 10.5 million or 22 percent from present law, whereas the Combination A system would reduce the number by 9 million or almost 19 percent.

Theoretically, either Combination A or Combination B type exemptions could be scaled up or down to produce any given over-all revenue goal. However, such adjustment of the level would encounter the difficulty that a dependent exemption even slightly below $400 would result in an actual decrease in the exemption for married couples with 2 or more dependents under Combination B. Under Combination A, the dependent exemption could go slightly below $400 with an actual decrease of total exemption resulting only for married couples with 6 or more dependents. However, if Combination A exemptions were scaled down to $700-$1,400-$350, the exemption would be decreased from present law for married couples with 3 or more dependents.

It may also be noted that assuming an $800 exemption for single persons and $400 for dependents, Combination A would allow $1,600 for married couples and reduce revenue by an estimated $3.3 billion or more than twice as much as Combination B, which would allow $1,200 for married couples.

2. Equity considerations

As shown in the following table, Combination B corresponds somewhat more closely to the available data on relative incomes yielding comparable standards of living to single persons as compared with married couples. However, Combination A shows somewhat closer correspondence to the income relatives with respect to dependents as compared with principals.

Comparison of exemptions under per capita and Combinations A and B, with relative incomes, for specified family sizes

Married, no dependents = 100

Exemption status	Relative incomes a/		Exemptions		
	Saving criterion	Diet criterion	Per capita	Combination A	Combination B
Single, no dependents	70	b/	50	50	67
Married, no dependents	100	100	100	100	100
Married, one dependent	127	129	150	125	133
Married, two dependents	151	154	200	150	167
Married, three dependents	172	176	250	175	200
Married, four dependents	191	198	300	200	233

a/ For explanation of construction and source, see Appendix II (pp.
b/ Not available.

Combination B would provide a greater margin of relief for single persons for a given amount of decrease in revenue. However, Combination B is open to the objection on social and equity grounds that it would increase the tax liability of two persons because of marriage. While the budget data appear to indicate economies in joint living expenses through marriage, it might nevertheless be considered undesirable and unfair to adjust the marital exemption so as to impose a higher tax on a married couple than on two single persons with the same combined income. In the first place, single persons may obtain some of the economies obtained by married persons by sharing living quarters. To a considerable extent, the lower personal budget shown for a married couple as compared with two single persons is probably due to household services performed by the wife and, consequently, there is the question of the desirability of taxing this kind of real income. Where the wife is employed outside the home, these economies may not be available. 1/

1/ In view of the resulting unfavorable treatment of married couples where both spouses are employed, the adoption of Combination B might tend to call for a working-wife credit. For example, in Great Britain where the married couple exemption is less than twice that of a single person, an additional allowance up to a maximum of \$440 is granted the couple if the wife has earned income.

On the other hand, there are some factors in the existing income tax system which may be considered as relatively advantageous to married couples compared with single persons as a group. These factors might be regarded as calling for an offsetting adjustment of relative exemptions in favor of single persons. For example, the exclusion of a dependent's gross income under $500 raises the effective exemption for a dependent with income to $999. Married couples are perhaps more apt to have dependents supplementing the family income than single persons. Moreover, where both husband and wife have income, the couple may receive (in addition to the tax advantage of dividing income between husband and wife for tax purposes) a higher standard deduction on a combined income above $5,000 than a single person with the same income. 1/

3. Burden distribution 2/

a. Comparison of individual liabilities under $600 per capita and Combination B, $800-$1,200-$400 3/

Two major points should be noted: (1) Combination B would be more favorable than $600 per capita to single persons with no dependents, equally favorable for married couples with no dependents, and less favorable for married couples with dependents, and (2) Combination B would involve a reduction in exemption from present law for married couples with more than two dependents.

In the case of married couples with no dependents, $600 per capita and Combination B, $800-$1,200-$400, would result in identical burdens. Each method would increase the exemption $200 over present law and reduce liabilities by $38 for taxpayers with incomes in the first surtax bracket. (Tables 5b, 5c and 6a, pages 77-80 and 86.)

1/ The standard deduction is 10 percent of adjusted gross income, the maximum standard deduction being $500. However, the maximum combined standard deduction is $1,000 for the couple filing separate returns as against $500 for the single person.

2/ A detailed comparison of individual liabilities under present law and a number of alternative exemption systems are presented in Tables 5 to 5c (pp. 73-84).

3/ See Tables 6, 6a, 6b (pp. 85-87) for a comparison of individual burdens under exemptions of $600 per capita and Combination B, $800-$1,200-$400 assuming present law rates.

For single individuals with no dependents, Combination B would provide an $800 exemption as against $600 under the per capita method, resulting in a tax difference of $38 for taxpayers with incomes in the first surtax bracket. For such taxpayers, $600 per capita would reduce the tax by $19 as compared with present law while Combination B would provide a reduction of $57. (Tables 5, 5a, and 6, pages 73, 75, and 85.)

The differences are more striking in the case of married couples with two dependents. Here $600 per capita would provide a total exemption of $2,400 as against $2,000 under Combination B and under present law. The tax difference between the two proposals would amount to $76 for taxpayers with incomes in the first surtax bracket, reflecting the fact that for such taxpayers $600 per capita would reduce the liability by $76 from present law whereas Combination B would provide no reduction in tax from present law. (Tables 5d, 5e and 6b, pages 81, 83, and 87.)

It should also be noted that $600 per capita would provide progressively higher exemptions for larger families, whereas Combination B, $800-$1,200-$400, would result in progressively less exemption and higher tax as compared with present law for married couples with three or more dependents.

b. Comparison of individual liabilities under $700 per capita and Combination A, $800-$1,600-$400 1/

It is important to note that (1) Combination A would be more favorable than $700 per capita to both single persons with no dependents and married couples with no dependents but less favorable to married couples with one or more dependents, and (2) Combination A would not involve an actual reduction of exemption from present law except for married couples with more than six dependents.

For both single individuals with no dependents and married couples with no dependents, Combination A, $800-$1,600-$400, would provide higher exemptions and greater relief than $700 per capita. The tax difference between the two methods would be $19 in the case of single persons with no dependents and $38 in the case of married couples with no dependents, assuming income in the first surtax bracket. Both would afford substantial relief as compared with present law. (Tables 5 to 5c, 7 and 7a, pages 73-80, and 88-89.)

1/ See Tables 7, 7a, 7b (pp. 88-90) for a comparison of individual burdens under exemptions of $700 per capita and Combination A, $800-$1,600-$400, assuming present law rates.

For married couples with two dependents, $700 per capita would provide a total exemption of $2,800 as compared with $2,400 under Combination A, $800-$1,600-$400, and $2,000 under present law. Thus, for such taxpayers, $700 per capita would reduce the tax by $152 from present law, as against a $76 reduction under Combination A, assuming income within the first surtax bracket. (Tables 5d, 5e and 7b, pages 81, 83, and 90.)

In addition, it is significant that the $700 per capita exemption is progressively more favorable than Combination A, $800-$1,600-$400, for larger families. While Combination A, $800-$1,600-$400, would provide some exemption increase over present law for family statuses up to married, six dependents, the increase would be smaller the larger the family. For married couples with six dependents Combination A, $800-$1,600-$400, would allow a total exemption of $4,000, the same as present law, but for larger families it would result in an actual decrease in the total exemption as compared with present law.

4. Compliance and administration

The per capita exemption system has made a number of important contributions to income tax simplification. Briefly stated, the per capita system: (a) streamlined and simplified the use of the Supplement T and withholding tables, 1/ (b) eliminated the troublesome head-of-family status, (c) avoided need of prorating exemption in case of intra-annual change in marital status, and (d) provided the basis for simplified filing requirements.

While both Combination A and Combination B would provide exemptions which were in all cases a multiple of the dependent exemption so that a streamlined tax table would be possible, each would have disadvantages. Combination A would raise a head-of-family problem since it would allow more exemption for a married couple than for a single person maintaining a household for a dependent. While Combination B would avoid the head-of-family difficulty, it would entail complications in connection with separate returns of husband and wife, as well as a prorating problem in case of intra-annual change in marital status. Both of these

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1/ The Supplement T table is used by the majority of taxpayers filing Form 1040 returns. It is also used by the Bureau in computing the tax of wage earners filing Form W-2 returns. According to tabulations for 1944, of a total of 47.1 million individual income tax returns for 1944, 18.4 million or 39 percent were Forms W-2. Another 18.9 million or 40 percent were Forms 1040, using the Supplement T table to determine tax. Thus, only about 9.7 million returns (about 21 percent of the total or one-third of all Form 1040 returns) involved arithmetic computation of tax.

difficulties stem from the fact that Combination B would allow the married couple a smaller combined exemption than the total for two single persons. For the sake of convenience, per capita and differential systems A and B are compared in greater detail with respect to the major points of compliance and administration in the following table. 1/

On balance, it appears that Combination A would involve less difficulty from the compliance and administrative standpoint than Combination B. This conclusion is based on the considerations that the problems connected with separate returns of husband and wife under Combination B would be more serious and affect more taxpayers than the head-of-family difficulty under Combination A. In addition, the scope of the prorating problem under Combination B, arising in case of change of marital status, would be greater than under Combination A where it would be limited to marriage (or separation) of persons entitled to be family heads. Moreover, filing requirements both for returns and declarations of estimated tax would be somewhat simpler under Combination A than under Combination B.

1/ A possible variation of Combination B would be the following: (1) allow the single person an exemption of, say, $800; for the first dependent of a single person, $400 (in fact, any amounts of single-person and first-dependent exemptions would be suitable, provided their sum equals the married-couple exemption); for each subsequent dependent, $600; and (2) allow the married couple an exemption of $1,200, with $600 for each dependent. From the standpoint of individual burdens, this plan would be the same as $600 per capita, except for the single person with no dependents who would receive the relatively higher exemption characteristic of Combination B. This suggestion would retain the general form of the present Form 1040 tax table, with the addition of a special column for single persons with no dependents. This might permit the present simplified method of translating family status into exemption amounts or relating it to the proper column in the tax table for all married taxpayers and all single taxpayers with dependents. However, it would involve special instructions and compliance and administrative difficulties in connection with the special $800 exemption (tax table) column for single persons with no dependents. In particular, confusion and enforcement problems would arise in connection with the $800 exemption allowance for single persons with no dependents as compared with $600 each for married persons with no dependents filing separate returns. However, in this respect the proposed variation might involve no more difficulty than Combination B.

Comparisons of per capita and differential exemption systems with regard to administrative and compliance considerations

Exemption method	Streamlining and use of Supplement T and withholding tables	Head-of-family problem	Problems connected with separate returns of husband and wife	Problem of prorating in case of change in marital status	Filing requirements for income tax returns and declarations of estimated tax	Other problems
Per capita	Satisfactory	None	None	None	Satisfactory a/	None
Combination A (e.g., $800-$1,600-$400)	Tables could be streamlined with single-column heading. However, use of tables would be more difficult b/	Yes c/	None	Yes, if head-of-family status provided d/ e/	Same as per capita with respect to returns. Would tend to require additional tests to determine liability for filing declarations. f/ Would raise new problems with regard to reporting of dependent's income g/	If head-of-family status automatically allowed for first dependent, administrative problem of preventing claims for head-of-family status on separate returns of husband and wife
Combination B (e.g., $800-$1,200-$400)	Tables could be streamlined with single-column heading. However, use of tables would be more difficult b/	None	Yes h/	Yes i/ e/	Would necessitate different filing requirements for returns based on marital status. Would involve more tests than either per capita or Combination A to determine liability for filing declarations. j/ Would raise new problems with regard to reporting of dependent's income g/	Administrative problem of preventing both spouses from filing separate returns as single persons

Footnotes on next page.

Comparisons of per capita and differential exemption systems with regard to administrative and compliance considerations

Footnotes

a/ One test, $500 gross income, for filing returns. Two additional tests to determine liability for filing declarations: (1) wages subject to withholding in excess of $5,000 plus $500 for each exemption other than the taxpayer's own and (2) other income above $100.

b/ Under present law, the taxpayer or the collector counts the number of names listed on the return and finds the corresponding columns on the tax table. Under Combination A or B, it would be necessary to count or add up exemption units or dollar amounts of exemption and find the corresponding tax column.

c/ Would accord less exemption for dependent than for spouse. Three alternatives for meeting the problem are: (1) deny head-of-family status, (2) allow head-of-family status as defined under pre-1944 law, and (3) allow head-of-family status automatically for first dependent. None of these solutions would be entirely satisfactory.

d/ Marriage of persons entitled to head-of-family status would involve some loss of exemption (equal to the amount of one dependent exemption where only one family head was involved and two dependent exemptions where two family heads were involved).

e/ Alternative methods of handling the problems include: (1) prorating as under pre-1944 law, (2) status determination favorable to the taxpayer in all cases, (3) status determination date favorable to the taxpayer in some instances and unfavorable in other instances, depending on the date of change of marital status.

f/ Tests for wages subject to withholding would need to be related specifically to marital (or household) status, as well as to number of dependents.

g/ If dependent's income test were geared to dependent exemption, this amount would differ from minimum filing requirement.

h/ Would require unequal division of exemption between husband and wife filing separate returns and using the table method of computing tax. This would necessitate special instructions and an additional column on the Supplement T table for the spouse taking the smaller exemption.

i/ Marriage would involve some loss of exemption (equal to the amount of one dependent exemption).

j/ Tests for wages subject to withholding would need to be related specifically to marital status and joint or separate filing by husband and wife, as well as number of dependents.

5. Technical problems

a. Dependent's income

In the event of an increase in the exemptions on either a per capita or differential basis, it may be desirable to re-examine the treatment of a dependent's income, now disregarded for tax purposes up to $500. 1/ The question is also raised whether, under differential exemptions, the income test for a dependent should be equal to the minimum filing requirement (presumably equal to the single person's exemption) or the dependent exemption.

b. Filing requirements

In connection with exemption revision, it may be desirable to consider the possibility of relating the filing requirement to marital status in order to eliminate some nontaxable returns. Different filing requirements for single persons and married couples were a feature of pre-1944 law. Under Combination B, for example, it might be necessary to introduce filing requirements of $800 for single persons and $1,200 of combined income of married couples in order to ensure full reporting of income without excessive nontaxable returns. 2/

V. Alternative adjustments in lieu of higher exemptions

While exemptions against income have been a traditional feature of the Federal income tax, various alternative methods are available for relieving low incomes or taking account of family status. Such possibilities include (1) credits against tax, (2) low starting rate, and (3) minimum taxable income limit. 3/ These alternatives are briefly discussed below.

1/ One suggestion is to require the taxpayer to include on his own return any income received by a dependent claimed for income tax purposes.

2/ Under Combination B, exemptions of $800-$1,200-$400, for example, a flat filing requirement of $800 would permit one spouse to claim an $800 exemption while the other would not be required to report amounts up to $799, which would result in an effective exemption of $1,599, as compared with the $1,200 exemption accorded married couples. On the other hand, if a flat filing requirement of $400 were introduced to avoid this problem, it would result in an unnecessarily large number of nontaxable returns.

3/ Still other alternatives include vanishing exemptions, rate differentials for family status, family allowance payments, and deductions which are closely related to family circumstances. All of the methods here mentioned have been used at one time or another in various countries or the States. Tax credits are now used under the income tax in 5 States: Arizona, Iowa, Kentucky, Minnesota, and Wisconsin. Effective beginning with 1947 incomes, Canada has abandoned the partial use of tax credits and returned to the method of allowing all income tax exemptions in the form of deductions from income.

A. Tax credits in lieu of exemptions

1. Description of proposal

In typical form, the tax credit proposal would substitute for a given exemption a credit against tax equal to the starting rate times the amount of such exemption. Under such a proposal, the present $500 per capita exemption would be replaced with a $95 per capita credit against tax. The normal tax and surtax rates would then begin to apply with the first dollar of net income.

2. Major effects

The substitution of tax credits for exemptions would (a) increase revenue without increasing the bracket rates, permitting higher effective exemption levels or lower rates with the same revenue goal, (b) increase the burden on larger as compared with smaller family units, this effect being particularly significant for the middle-income groups, and (c) make possible a new type of Supplement T table.

a. Revenue

It is estimated that tax credits of $95 per capita in lieu of the present exemptions of $500 per capita, with no other change from present law, would increase income tax revenues by about $643 million annually, assuming $166 billion income payments to individuals. Of this total increase, about $642 million would be paid by approximately 48.5 million individuals already taxable under present law, while about $1 million would be paid by about 91,000 new taxpayers, with net incomes above $2,000, 1/ added to the rolls under the proposal. About 49 percent of the increase in revenue would be paid by individuals with net incomes under $5,000; about 51 percent, by those with net incomes above $5,000.

b. Burden distribution

A comparison of amounts and effective rates of individual liabilities under present law and under tax credits of $95 per capita, for various family statuses and selected amounts of net income, is presented in Tables 8, 8a and 8b. (Pages 91-93.)

1/ Net incomes above $2,000 would be subject to higher than first bracket rates if the tax before credit applied beginning with the first dollar of net income. For such incomes a $95 credit would be equivalent to less than a $500 exemption. For example, a married couple with four dependents receiving $3,000 net income is not subject to tax under present law. Under the tax credit plan described here, with present law rates, this family would pay a tax of $19. This is due to the fact that the tax saving from each of the last two $500 exemptions is $104.50, computed at the present second surtax bracket rate of 20.9 percent, as against $95 tax saving for each exemption under the tax credit plan.

As shown in the tables, the $95 per capita tax credit would result in significant increases in individual burdens under existing rates and a shift in relative burdens among different groups. As noted in the previous section, it would increase the tax for all existing taxpayers with net incomes above $2,000. It would add to the tax rolls a number of persons with net incomes above $2,000 with more than four exemptions who are not subject to tax under present law. The proposal would not increase the tax of existing taxpayers with net incomes below $2,000 nor add to the rolls any individuals with net incomes below $2,000.

The figures in these tables also indicate that the tax increases under tax credits are greater for married couples than for single persons, and greater for larger than for smaller families. The increases in dollar amounts of tax are greater the higher the income, but are particularly significant as a percentage of net income for taxpayers in the middle brackets. The largest effective rate increase shown is 3.2 percent of net income, applicable to a married couple with two dependents, receiving $15,000 net income. This compares with a .9 percentage-point increase in the effective rate for a single person with no dependents receiving the same income.

One important explanation of the burden changes under tax credits as against exemptions is found in the fact that the tax value of the exemption, like any deduction, is greater the higher the income, ranging from $95 under the 19-percent starting rate to $432, under the 86.45-percent top rate. Under tax credits, the tax saving due to a given marital or dependency status is the same regardless of income.

Whether the tax credit method results in a fairer distribution as between large and small families raises the difficult question of how to appraise relative abilities to pay of families of different size. However, it should be noted that some observers regard present exemptions as insufficient to distinguish between the ability to pay of a single person with, say $10,000 income, as against a married couple with several children and the same income. 1/ As compared with present exemptions, the tax credit method would narrow the tax difference between families of different size and the same income.

c. Simplification

Per capita tax credits could be incorporated into the present type of Supplement T tax table. However, the point has been made that a change from an exemption to a tax credit system, involving a sharp decrease in the nominal (although not necessarily the substantive) amount of exemption allowance, might tend to result in some taxpayer confusion and misunderstanding.

1/ This view is also discussed in the Colwyn Committee Report (Royal Commission on the Income Tax, Great Britain, 1920), p. 60.

The tax credit method would permit the use of a new and more flexible tax table applicable to any kind of differential tax credit combination. Such a table would consist of two columns, one for income and the other for tax before tax credit. In using this type of tax table, the taxpayer would read off his tentative tax from the table, then subtract the amount of his credit to arrive at his final liability. Compared with the present tax table which includes the final liability without adjustments, the deduction of per capita tax credits from a tentative tax would be more difficult for taxpayers, and for collectors of internal revenue in computing and checking tax liabilities of taxpayers using the tax table. However, this two-column tax table would compare more favorably with the present type of tax table if differential exemptions are involved. The two-column type of tax table would operate the same way under any type of differential credit combination. This additional element of flexibility in the relative amounts of credit for single persons, married couples, and dependents would constitute a point to be considered in the event it was found desirable to depart from the per capita exemption system. 1/

B. Low starting rate

A narrow, low-rate starting bracket has been discussed as a means of granting substantial relief to low-income persons without necessarily changing the exemption structure. Under such provision the present $2,000 first bracket might be split into four $500 brackets, two $1,000 brackets, or a $500 bracket followed by a $1,500 bracket. A special low starting rate is characteristic of the British system. 2/

A low-rate starting bracket would ease the impact of the income tax and provide rate graduation at low-income levels. Under the present type of rate schedule, progression applicable to incomes falling entirely within the first surtax bracket is limited to progression of effective rates on net income before exemption. In this important area, which includes the great bulk of the taxpayers and more than half of the tax base, no progression is provided with respect to the bracket rate applicable to net taxable income after personal exemptions. By contrast, there is a multiplicity of rate brackets at higher income levels where there are relatively few taxpayers. Under the circumstances, some students of taxation believe there may be considerable merit in introducing more rate graduation for low-income taxpayers in order to provide a more progressive tax distribution among the great majority of taxpayers.

1/ A similar two-column tax table could be constructed under the present exemption system which would be applicable to either the adjusted gross income after deduction of exemptions or to net income after deduction of exemptions and allowable deductions.

2/ Under the British income tax for 1947-48, the first $200 of taxable income after exemptions and allowances is subject to a 15-percent rate and the next $300 is taxable at 30 percent, the balance being subject to the standard rate of 45 percent. See British Finance (No. 2) Act, 1945.

In this connection, the following facts are significant. At $166 billion of income payments it is estimated that the first surtax bracket, under present law, would account for almost $50 billion or 72 percent of the total surtax net income of $69 billion, and about $9 billion or 56 percent of the total normal and surtax yield of almost $17 billion. Moreover, about 41 million or almost 85 percent of the estimated total of $48\frac{1}{2}$ million income taxpayers would have income falling entirely within the first surtax bracket. These taxpayers would account for $35 billion of the $50 billion of income in the first surtax bracket or 51 percent of the total surtax net income. 1/

Because of the breadth of the tax base at income levels just above the exemptions, a low starting rate would cost large amounts of revenue. For example, a starting rate of 10 percent applicable to the first $500 of surtax net income with no other change from present law would reduce revenue about $1.9 billion, assuming $166 billion income payments. This is larger than the $1.65 billion decrease in revenue resulting from an increase in exemptions to $600 per capita.

The proposal would also involve a number of compliance and administration problems. (1) It would encourage separate returns at low-income levels, aggravating problems connected with community property and, to a lesser extent, income-splitting for tax purposes. (2) A larger number of returns would be filed, thereby increasing the administrative work load involved in handling and checking returns. (3) Overwithholding would be increased, with additional refunds to be administered, where wages varied above and below the low-rate bracket. (4) Withholding by the percentage method, used by a substantial number of large employers, would be more complicated.

C. Exempting incomes below a specified level

It may be desirable to examine the possibility of exempting all incomes below some specified amount, for example, $1,000, without changing the exemption allowance for persons subject to tax. This would involve a limitation on the tax applicable to incomes just above the minimum taxable income limit to prevent the tax from reaching or even exceeding 100 percent of income in excess of such limit. 2/ A minimum taxable income limit, similar to the method discussed here, is used under the British income tax. 3/

1/ Hearings before the Committee on Ways and Means on H. R. 1, March 13 and 14, 1947, op. cit., Appendix to statement of the Secretary of the Treasury, Chart A, p. 33.

2/ A so-called notch limitation.

3/ This minimum taxable limit was important during the war years. Under the present British income tax, the minimum limit has significance only for single persons under 65 years of age who receive their small incomes from investments.

Such a provision might be useful, for example, to provide temporary relief for hard-pressed, low-income recipients now entitled only to one $500 exemption. It would concentrate the relief among low-income, single persons with no dependents, retain the existing base in substance, and necessitate no significant structural revision. A major disadvantage is the necessity for a notch provision with relatively steep rates of tax applicable to each additional dollar of income within a range of income just above the minimum taxable income level, a characteristic of such provisions. 1/

1/ For example, under a minimum taxable limit of $1,000 net income, assuming present law rates and exemptions, a notch provision limiting the liability of low-income taxpayers to 50 percent of income above $1,000 would result in a 50-percent rate applicable to each dollar of net income between $1,000 and $1,306, for single persons with no dependents. It would also involve complexities in connection with separate returns of married persons.

APPENDIX I

Function and Purpose of Individual Income Tax Exemptions

A. Differing views and concepts of the exemptions

One question is whether some amount of income, determined with reference to some minimum living standard, should be relieved of tax. A related and perhaps more difficult question is how to define such minimum living standard for this purpose. The history of the income tax reflects widely differing views with regard to these questions. These differences in viewpoint are not peculiar to the income tax field, but to a considerable extent merely reflect wider disagreement regarding principles of tax burden allocation.

1. No exemptions

At one extreme, it may be held that the entire income should be included in the tax base without exemption. For example, the municipal income taxes now imposed by Philadelphia, Toledo, and St. Louis provide no personal exemption. Municipal income tax rates are low and the need for exemptions therefore not comparable to that under the Federal tax. Nevertheless, a high-rate income tax without exemptions is sometimes defended on the ground that (a) the income tax is not necessarily confined to a tax on surplus income and is inherently a better tax, with or without exemptions, than other taxes, and (b) some direct share in governmental costs should be a part of every individual's budget. In this view, any exemption should be solely for administrative reasons and to prevent incurring collection costs disproportionate to the revenue involved.

2. The relative approach

Another view is that the exemption should not be determined with reference to given living standards or any other absolute criterion but should be considered in relation to the entire economic and fiscal situation at any time. Thus, it is stressed that living standards should not be regarded as absolute but as relative to national income. Moreover, it is a part of this general approach that income tax exemptions should not be considered independently of other taxes or of the kind and amount of Government expenditures. One aspect of this approach is the suggestion that exemptions should be designed to include some substantial percentage of all income recipients or families on the tax rolls and to exclude some proportion, say, one-third or one-fourth. A similar suggestion is to fix exemptions so as to ensure the inclusion of some substantial fraction of total income payments in the tax base.

Those who favor this approach also are concerned lest a philosophy of exempting some hard and fast living standard may unduly narrow the income tax base and result in a shift of income tax burden to higher brackets where work and investment incentives may be impaired, or in the adoption of some other less desirable form of tax. Payment of direct taxes by most adult citizens is also considered desirable to ensure broad public interest in the management of Government expenditures and the public debt. The relative approach to exemptions would tend to retain a broad base, yet relieve from tax some specified proportion of individuals and families relatively least able to pay. 1/

3. Minimum living standard

According to a widely accepted view, the exemption should be at least adequate to cover some minimum of essential living costs, such as the amount required for reasonable maintenance. 2/ It is conceded that the adjustment of exemptions to living costs may not be exact and that under emergency conditions it may be necessary to go below ordinary minima. For the long run, however, it is regarded as essential to exempt amounts required to maintain the individual and his family in health and efficiency.

Apart from humanitarian aspects, this view is based on certain practical social and economic considerations. Thus, it is held that taxing substandard living will result in lowered economic vitality in the community, lower revenues, and possibly result in higher Government expenditures for social repairs. According to this view, (a) the income tax is a "surplus" tax and (b) exemptions are in lieu of personal expense deductions, disallowed as a general rule 3/ for income tax purposes. In this view, ability to pay does not commence until a point is reached in the income scale where the minimum means of life have been obtained. Moreover, it is held that the individual income tax would not serve as a means of fairly distributing sacrifice unless subsistence was exempted since the sacrifice involved in going without certain necessities is not susceptible of measurement or comparison. Presumably, acceptance of such a minimum amount for exemptions would not bar higher amounts if revenue needs permitted.

1/ For a discussion of some of the points raised here, see Harold M. Groves, Postwar Taxation and Economic Progress, Committee for Economic Development Research Study, pp. 165-174. For example, Groves states: "A tax system that protects from taxes one-third of American income recipients and between one-half and two-thirds of the income of all recipients cannot be said to err on the side of harshness..."

2/ For example, in connection with the enactment of the Federal individual income tax in 1913 it was stated in the Senate: "The House framed its bill upon the theory that $4,000 was a reasonable amount, in its opinion, for an American family to live upon, with a proper standard of living, and that a sum below that ought not to be taxed." Senator Williams, Congressional Record, Vol. 50, Part 4, 63rd Cong., 1st Sess., August 28, 1913, p. 3851.

3/ Exceptions include interest on personal debt or home mortgage, charitable contributions, specified personal tax payments, and unusual medical expenses.

4. <u>High living standard</u> 1/

According to some thought, no individual or family should be required to pay income tax until income is adequate to cover high standards of nutrition, housing, clothing, medical care, and other elements of welfare. The content of such a living standard, sometimes termed the American standard, is not always precisely defined. In practice, however, the dollar amounts suggested by labor groups advocating such exemption standards tend to approximate the Federal income tax exemptions allowed during the prewar period. 2/

B. <u>Functions of income tax exemptions</u>

Whatever view is taken with regard to the specific level of exemption which is desirable under given circumstances, it is generally recognized that a number of basic functions are performed by the personal and dependent exemptions. To these functions the income tax owes its precision and flexibility as an instrument for allocating tax burdens. 3/ These are listed briefly below.

1/ In legislative discussions of the Federal individual income tax in 1913 it was urged in the House that a direct tax on income "ought to leave free and untaxed as a part of the income of every American citizen a sufficient amount to rear and support his family according to the American standard and to educate his children in the best manner which the educational system of the country affords." Representative Palmer, <u>Congressional Record</u>, Vol. 50, Part 2, 63rd Cong., 1st Sess., May 6, 1913, p. 1250.

2/ For example, CIO representatives in 1945 suggested exemptions of $1,000 for single persons, $2,000 for married couples, and $500 for dependents on the basis of the Heller Committee health and decency budget of about $3,000 (including taxes) for a wage-earner family of four. (Revenue Act of 1945, <u>Hearings</u> before the Committee on Finance, United States Senate, 79th Cong., 1st Sess., on H. R. 4309, p. 106.) These amounts compare with exemptions of $1,000 for single persons, $2,500 for married couples, and $400 for dependents under 1932-1939 law. More recently, the CIO has recommended exemptions of $1,250, $2,500, and $500 for single persons, married couples, and dependents, respectively. Cf. <u>Report of the Resolutions Committee</u>, submitted to the Eighth Constitutional Convention of the Congress of Industrial Organizations by the Committee on Resolutions, November 18-22, 1946.

3/ Analogous devices designed to exempt a minimum standard of consumption are also used under various other taxes, such as the homestead exemption under the property tax, the exemption of food under sales taxes, and selection of luxury or nonessential items as subjects of excise taxes. However, these devices are less effective than the income tax exemptions. The specific exemptions under the Federal estate and gift tax are technically comparable to income tax exemptions. Although the estate tax applies at a much higher level of ability to pay, it is sometimes held that the exemption should equal a sum adequate at current rates of investment return to make reasonable provision for the decedent's widow or family.

1. Exempting from tax individuals with very low incomes

Perhaps the major function of the exemptions is to determine minimum levels of income subject to tax. This involves such important aspects as the point in the income scale where tax begins to apply, the length of the tax rolls, and the size of the tax base.

2. Providing progression in effective rates

In certain respects the exemption is like a zero rate bracket. As such, it results in the application of scheduled rates of tax to a higher proportion of income the larger the individual's income. Therefore, it makes the effective rate progressive for incomes entirely within the first surtax bracket and supplements rate graduation applicable to higher incomes.

3. Taking account of family status

An important merit of the individual income tax is its capacity to take account of differences in ability to pay due to family responsibilities. This is the function of exemptions for marital status and dependents, which allocate the burden as between individuals with the same net income, but different family status, as well as between high- and low-income groups. 1/

4. Exemption changes as a method of adjusting burdens

Increases or decreases in the exemption level have characteristic effects on the burden distribution. A change in the exemption has a proportionately greater effect on tax liability the lower the individual's income, as compared with (a) a reduction in rate equal to a given number of percentage points in each bracket or (b) a flat percentage reduction in tax across the board. 2/

1/ In this connection, it is sometimes held that fixed dollar amounts of exemption which are adequate to distinguish the taxable capacity of large and small families at lower income levels are inadequate as between different-sized families with larger incomes. This view would lead to exemptions expressed as a percentage of income. See Colwyn Committee Report, Report of the Royal Commission on the Income Tax, Great Britain, 1920, p. 60.

2/ To illustrate, an additional $100 exemption subtracted from income subject to the present 19-percent starting rate would reduce tax by $19. As a percentage of tax this would vary with the individual's existing tax, ranging up to 100 percent for individuals dropped from the rolls. As applied against income subject to the top rate of 86.45 percent, the $100 exemption would decrease individual liability by a larger dollar amount, namely, $86.45, but a negligible percentage of existing tax. By contrast, a rate reduction of 2 percentage points in each bracket would reduce the tax by about 10 percent at the lower end of the income scale and about 2.3 percent for very high incomes.

APPENDIX II

Method of Obtaining Estimates on Relative Incomes

The following two exhibits give a brief account of the procedures used by the Bureau of Labor Statistics in estimating relative incomes needed by families of different size to obtain about the same level of living. Exhibit 1 is a letter from the Bureau of Labor Statistics summarizing its analysis of savings and dietary data from surveys of consumer income and expenditures. Exhibit 2 is a memorandum from the Bureau of Labor Statistics giving a more detailed explanation of the method and sources of information used.

Exhibit 1

U. S. DEPARTMENT OF LABOR
Bureau of Labor Statistics
WASHINGTON
(25)

January 17, 1946

Division of Tax Research
Treasury Department
Washington, D. C.

This is to transmit to you the results of our analysis of data on family expenditures to measure the incomes yielding the same standard of living among families of different sizes.

Two criteria were selected as defining the same standard of living among the different family groups, (1) the percentage of income saved and (2) the percentage of families having fair or good diets. The data from the Bureau's Survey of Spending and Saving in Wartime (1941) and Survey of Prices Paid by Consumers (1944) were used to determine the relationship between the incomes at which the savings of families of different sizes amounted to the same percentage of the income. The average relationship among families of 2 or more was found to be:

$$\log y = a + .59 \log x$$

Where "y" is the amount of income, and "x" is the number of persons in the family. The parameter "a" is a function of the level of savings. This relationship does not extend to one person families. The ratio of incomes of the one person family to the incomes of the two-person family averaged 70 percent.

The data indicated some tendency for the parameter "b", which averaged .59, to increase with the level of savings. The increase, however, was not large enough to regard as significant without analyzing data from earlier surveys more completely than has been possible to date.

The data from the dietary studies made in 1935-36 were used to determine the relationship between the incomes at which the percentage of good and fair diets among families of different sizes were the same. The average relationship among families of 2 or more was found to be:

$$\log y = a + .62 \log x$$

Where "y" is the amount of income and "x" is the number of persons in the family. The dietary studies did not cover one person families.

The relative income levels indicated by the two criteria are as follows:

Size of family	Relative income (two-person family = 100)	
	Same percentage of savings	Same percentage of good and fair diets
1	70	-
2	100	100
3	127	129
4	151	154
5	172	176
6	191	198

The fact that the two criteria led to so nearly the same relationship supports the credibility of the results. I trust you will regard them as sufficiently reliable to use in connection with your current analysis of exemptions. The Bureau will not be able to extend the analysis of the family size relation during the next few months. The Bureau's staff will be very glad, however, to discuss with you the methods used in arriving at these summaries.

Very truly yours,

/S/ A. F. Hinrichs

A. F. Hinrichs
Acting Commissioner of Labor Statistics

Exhibit 2

Equivalent Incomes for Families of Different Size

The determination of the relative incomes providing families of different size the same scale of living depends on the definition of equivalence in well-being. The last two decades have seen a steadily increasing inventory of survey data relating one or more aspects of family living to the amount of family income. These studies range from detailed information on the need for and receipt of medical care, or detailed information on housing and housing facilities to general consumption studies covering less intensively all sectors of family living. Separate scales of equivalence among families of different size might be constructed for each aspect of family living or a composite scale could be attempted. Thus incomes could be called comparable which provide among families of each size the same percentage of families with adequate diets or adequate housing or adequate medical care; or the same percentage of families receiving medical care for illness; or the same percentage of families owning various types of durable equipment; or the same percentage of income spent on food or housing or the same percentage of income allocated to savings. Such indexes of family welfare can be used separately to measure equivalent incomes or a rational combination could be devised. The desirability of an indicator combining several aspects of family welfare depends on the variation among separate scales based on different aspects of well-being.

Two separate scales have been developed, one based on the percentage of families with good or fair diets in terms of nutrition and another based on the percentage of income allocated to savings. These two measures of family welfare are probably more independent of each other than any other pair that could be selected from the available information.

The data on the percentage of families in each income bracket having good or fair diets appear in table 16 in Miscellaneous Publication No. 452, U.S. Department of Agriculture, Family Food Consumption and Dietary Levels. The incomes at which the same percentage of families of the several types achieved good or fair diets were determined from the table values by interpolation. Five levels were determined, 60, 65, 70, 75, and 85 percent of families with good or fair diets. The incomes at which each size of family reached the specific percentage with good or fair diets were then related to the size of family and were found to be straight lines on a logarithmic scale. Furthermore these lines were approximately parallel so that it may be concluded that the same relative scale for different sizes of family applies at each level of the indicator (the percentage of families with good or fair diets). The average relationship found in algebraic form was as follows --

$$\log y = a + .62 \log x$$

Where "y" is family income "x" is size of family and "a" depends on the level of the indicator.

The data on the percentage of income saved by families of different size are found in tables 3 and 4, of Serial No. R 1818, Bureau of Labor Statistics, Expenditures and Savings of City Families in 1944, in table 19, Bulletin No. 822, Bureau of Labor Statistics, Family Spending and Saving in Wartime and in the bulletins on family expenditures from the Consumer Purchases Study. The incomes at which families of different sizes had savings or deficits amounting to the same percentage of income were determined from the table values by interpolation. Seven levels were determined, deficits of 15 percent, 10 percent and 5 percent; no savings or deficit; savings of 5 percent, 10 percent and 15 percent. As in the case of the quality of diets, the incomes at which each size of family reached the specified level on the savings scale were found to be logarithmic straight lines in relation to the size of family and the lines were approximately parallel. The average relationship was in algebraic form --

$$\log y = a + .59 \log x$$

where "y" is family income, "x" is size of family and "a" depends on the level of savings.

The relationships found in these two measures are so similar that a composite of the two does not appear necessary. Since the other indicators that might be used are probably correlated either with the dietary indicator or with the savings indicator of equivalent well-being, it is not likely that other radically different scales would be produced by using this approach to the derivation of a family-size scale of equivalent incomes.

It should be noted that the data summarized in these relations apply to non-farm families. Similar analysis of corresponding data for farm families would yield without doubt a different set of relations.

Table 1

Personal exemption, credit for dependents, and net income not subject to surtax, under the Revenue Acts of 1913-1945

Revenue Act	Income year	Personal exemption and credit for dependents 1/			Net income 3/ not subject to surtax
		Single person	Married person or head of family 2/	Credit for each dependent	
1913	Mar. 1, 1913-Dec. 31, 1915	$3,000	$4,000	-	$20,000
1916	1916	3,000	4,000	-	20,000
1917	1917	1,000	2,000	$200	5,000
1918	1918-1920	1,000	2,000	200	5,000
1921	1921	1,000	2,500 4/	400	5,000
	1922-1923	1,000	2,500 4/	400	6,000
1924	1924	1,000	2,500	400	10,000
1926	1925-1927	1,500	3,500	400	10,000
1928	1928-1931	1,500	3,500	400	10,000
1932	1932-1933	1,000	2,500	400	6,000
1934	1934-1935	1,000	2,500	400	4,000
1936	1936-1937	1,000	2,500	400	4,000
1938	1938-1939	1,000	2,500	400	4,000
1940	1940	800	2,000	400	4,000
1941	1941	750	1,500	400	-
1942	1942-1943	500	1,200	350	-
1944 5/	1944-1945	500	1,000	500	-
1945	1946-	500	1,000	500	-

Treasury Department, Division of Tax Research

Footnotes on next page.

Table 1 - concluded

Personal exemption, credit for dependents, and net income not subject to surtax, under the Revenue Acts of 1913-1945

Footnotes:

1/ Prior to 1934, allowed for normal tax only. For 1934 through 1943 and for 1946 and subsequent years, allowed for both normal tax and surtax. For 1944 and 1945, allowed for surtax only; for normal tax, each taxpayer was allowed a flat exemption of $500, plus his spouse's adjusted gross income up to $500 if a joint return was filed.

2/ Subsequent to the Revenue Act of 1913, and prior to the Individual Income Tax Act of 1944, the personal exemption allowed to married persons was also allowed to heads of families.

3/ Prior to 1934, net income before personal exemption and credit for dependents; for 1934 and subsequent years, net income after personal exemption and credit for dependents.

4/ For net incomes in excess of $5,000, personal exemption was $2,000. The Revenue Act of 1921 provided that in no case should the reduction of the personal exemption from $2,500 to $2,000 operate to increase the tax which would be payable, if the exemption were $2,500, by more than the amount of the net income in excess of $5,000.

5/ Individual Income Tax Act of 1944.

Table 2

Recent available estimates of individual and family budgets and expenditures at various levels of living (annual cost in dollars 1/)

Source of estimate	Estimate at prices for: Region	Date	Type of individual or family: Single employed individual 2/: Living alone	Living as a member of a family	Dependent child in a family	Couple with husband employed	Typical family of four 3/
A. Health and decency level 4/							
Budget estimates							
1. Heller Committee standard budget 5/	San Francisco	Average for 1939-41					
Gross budget			1,113				2,318
Federal income tax			15 6/				-
Budget exclusive of Federal income tax 7/			1,098				2,318
2. Heller Committee wartime budget 8/	San Francisco	March 1944					
Gross budget			1,534				2,964
Federal income tax			203				186
Budget exclusive of Federal income tax 9/			1,331				2,778
3. Heller Committee standard budget	San Francisco						
a. As priced in September 1946 10/		Sept. 1946					
Gross budget			1,984				3,576
Federal income tax			245				232
Budget exclusive of Federal income tax 11/			1,739				3,344
b. Adjusted to Sept.1947 by price index 12/		Sept.1947					
Gross budget			2,189				3,972
Federal income tax			279				300
Budget exclusive of Federal income tax			1,910				3,672
4. Bureau of Labor Statistics estimate of D.C. budget 13/		Sept. 1946					
Gross budget			1,638				
Federal income tax			185				
Budget exclusive of Federal income tax 14/			1,453				
5. Utah Industrial Commission 15/	Utah	Mch.1945					
Gross budget			1,684				
Federal income tax			234				
Budget exclusive of Federal income tax 15/			1,450				
6. New York State Labor Department 16/	New York State	Oct.1945					
Gross budget				1,690			
Federal income tax 17/				234			
Budget exclusive of Federal income tax 18/				1,456			
7. Connecticut Labor Department 19/	Connecticut	Feb.-Mch. 1946					
Gross budget			1,420				
Federal income tax			147				
Budget exclusive of Federal income tax			1,273				
Expenditure estimates							
8. United Steelworkers' study 20/	United States steelworkers only	Sept.-Nov. 1943					
Total expenditures and taxes 21/							3,352
9. United Steelworkers' study 22/	Braddock, Pa.	Jan.1945					
Total expenditures and taxes							3,281 23/
Federal income tax							316 24/
Balance exclusive of Federal income tax 25/							2,965
Unclassified estimate 26/							
10. National Lawyers' Guild Proposal 27/	United States	1943			240-600 28/		

For footnotes, see pp. 59-62.

Table 2

Recent available estimates of individual and family budgets and expenditures at various levels of living (annual amount in dollars 1/)

Source of estimate	Estimate at prices for: Region	Estimate at prices for: Date	Type of individual or family: Single employed individual 2/: Living alone	Single employed individual 2/: Living as a member of a family	Dependent child in a family	Couple with husband employed	Typical family of four 3/
			B. Maintenance and emergency levels 29/				
Budget estimates							
1. Federal Security Agency							
a. Estimate for 33 large cities 30/		Dec.1942					
Average					225		
Highest cost - San Francisco					244		
Lowest cost - Mobile					201		
b. Estimate for 6 large cities 31/		May 1943					
Average					240		
Highest cost - New York, San Francisco					252		
Lowest cost - Houston					228		
2. Bureau of Labor Statistics estimate of WPA maintenance budget 32/	33 large cities throughout the country	June1943					
Average							1,673
Highest cost - New York							1,816
Washington, D. C.							1,809
San Francisco							1,807
Lowest cost - Mobile							1,497
3. Costs of WPA maintenance budget computed from BLS intercity index 33/	33 large cities throughout the country	March 1945					
Average							1,744
Highest cost - Seattle							1,899
Washington, D. C.							1,844
San Francisco							1,844
Lowest cost - Houston							1,623
4. Textile Workers' Union estimate of WPA subsistence budget 34/	5 textile manufacturing communities	Jan.-Feb. 1944					
Gross budget							1,752
Federal income tax							28
Budget exclusive of Federal income tax 35/							1,724
5. Heller budget for dependent families or children 36/	San Francisco						
a. As priced in September 1946		Sept. 1946					
Exclusive of medical care and insurance allowances				645-655 37/ 38/	278-502 37/ 39/	1,161 40/	1,782
Including medical care and insurance allowances						1,242 40/41/	1,945 42/
b. Adjusted to Sept. 1947 by price index 43/		Sept. 1947					
Exclusive of medical care and insurance allowances				708-719	305-551	1,275	1,957
Including medical care and insurance allowances						1,364	2,136

For footnotes, see pp. 59-62.

Table 2

Recent available estimates of individual and family budgets and expenditures at various levels of living (annual amount in dollars 1/)

Source of estimate	Estimate at prices for: Region	Estimate at prices for: Date	Type of consumer unit: Single persons	Families of two or more persons	2-person families	3-person families	4-person families	5-person families	Families of 6 or more persons
			C. "Break-even" point 44/						
Expenditure estimates									
1. Bureau of Labor Statistics Survey of Spending and Saving in Wartime 45/	United States civilian urban consumers	1941							
Computed break-even point (money income before taxes 46/)			714	1,527	1,478	1,422	1,777	1,528 47/	
2. Bureau of Labor Statistics survey of consumer expenditures 48/	United States civilian urban consumers	1944							
Computed break-even point (money income after personal taxes)			1,163	1,950	1,493	2,155	2,178	2,764	3,363
Income, poll, and personal property taxes at break-even point			117	119	77	158	108	146	199
Total expenditures and taxes at break-even point (money income before personal taxes)			1,280	2,069	1,570	2,313	2,286	2,910	3,562

1/ Except where otherwise indicated, Federal income tax liability is determined from the tax table on Form 1040 for the appropriate calendar year. For the Heller Committee budgets, the tax takes into consideration the community-property law of California.

2/ The data for single persons relate to a woman with no dependents to support, with the exception of the Heller Committee budget for dependent families or children, which relates to both sexes (see footnote 37).

3/ In the estimates based on budget studies the family typically consists of a moderately active man, wife, adolescent boy of 13, and preadolescent girl of 8, with the man being the sole wage earner in the family. In the Steelworkers' 1943 and 1945 expenditure studies, the expenditures represent average figures for all families covered, the average family size in each study being computed at 3.76 persons.

4/ The health and decency level is one which approximates what is generally regarded as an "American standard of living." As constructed by the Heller Committee of the University of California, it provides not only for adequate maintenance and protection of health as determined by scientific standards, but takes account of actual patterns of spending and allows enough to meet generally acceptable community standards of well-being for the different occupational groups, executive, "white collar," and wage earner. In the food allowances, consideration is given to consumer food habits, for example, the American habit of eating relatively large quantities of meat. The provisions for housing are designed to meet standards of size, good repair, sanitary facilities, and acceptable neighborhood. Amounts allowed for such items as clothing, household furnishings, cleaning supplies, and personal care are those indicated by expenditure studies as being generally acceptable. The budget further includes the ownership and use of an automobile in the case of a family, adequate medical care and recreation, life insurance premiums, all necessary taxes including Social Security (unemployment compensation and old-age insurance) taxes and the California retail sales tax of 2-1/2 percent on certain purchases, and numerous smaller items. For 1942-45 the Heller budgets took some account of wartime exigencies such as rationing, scarcities of many types of consumer goods, and desirability of investing as much as feasible in war bonds.

The Heller budgets selected for this portion of the table are those for a wage-earner family, presumably representing the minimum outlay with which a health and decency standard can be achieved. Although the other estimates shown here vary considerably, they are included under the health and decency level because their allowances appear to be substantially closer to the Heller concepts than to concepts based on the minimum maintenance and emergency standards set by the Works Progress Administration in 1935 (see footnote 29).

5/ The budget for a single working woman is taken from <u>Wartime Budget for a Single Working Woman, Prices for San Francisco, March 1943</u>, The Heller Committee for Research in Social Economics, University of California, p. 7, and assumes that the woman lives in a boarding house and obtains her weekday lunches and Sunday meals (except breakfast) in restaurants. The budget for a family of 4 is taken from another publication of this Committee, <u>Quantity and Costs Budgets for Three Income Levels, Prices for San Francisco, March 1942</u>, pp. 92-93.

Footnotes continued on p. 60.

Table 2

Recent available estimates of individual and family budgets and expenditures at various levels of living (footnotes continued)

6/ Average tax estimated assuming roughly $50 of deductions. The average of the 3 years' taxes on this basis would be about $12, and allowance of slightly higher income in the higher tax years would probably not increase the average tax beyond $15.

7/ Includes savings as follows: for the single working woman, $50 (for 1941); for the family of 4, that represented by ordinary life insurance premiums of $105.

8/ The budget for the single woman is taken from the Heller Committee publication Wartime Budget for a Single Working Woman, Prices for San Francisco, March 1944, p. 6, and assumes that the woman lives in a boarding house and obtains her weekday lunches and Sunday meals (except breakfast) in restaurants. The data for the family of 4 are from the corresponding study Wartime Budgets for Three Income Levels, Prices for San Francisco, March 1944, pp. 67-68.

9/ Includes savings as follows: for the single working woman, $65 worth of war bonds; for the family of 4, $295 worth of war bonds and $113 of life insurance premiums.

10/ The budget for the single woman is taken from the Heller Committee publication Quantity and Cost Budget for a Single Working Woman, Prices for San Francisco, September 1946, p. 16, and assumes that the woman lives in a boarding house and obtains her weekday lunches and all Sunday meals in restaurants. The data for the family of 4 are from the corresponding study Quantity and Cost Budgets for Three Income Levels, Prices for San Francisco, September 1946, pp. 70-71.

11/ Includes savings as follows: for the single working woman, $75; for the family of 4, that represented by $113 of life insurance premiums.

12/ For the single woman the price adjustment was made by multiplying the September 1946 budget total exclusive of Federal income tax by the change in the BLS consumers' price index for San Francisco from September 1946 to September 1947. The gross budget including tax was then determined so as to yield the adjusted figure after deduction of tax. Because of differences in content, such price adjustment in the case of the single woman is not considered valid by the Heller Committee, although the adjustment "can be applied to the Heller Committee's budgets for families to obtain a very fair approximation of costs between our pricing dates [except for income taxes]." (Quantity and Cost Budget for a Single Working Woman, September 1946, p. 5.)

The price adjustment for a family of 4 was made by the same method as for the single woman, taking into account the $3,000 maximum on wages subject to Social Security taxes.

Under the price adjustment, both the cash savings of the single woman and the insurance for the family of 4 (see footnote 11) are each increased in the same ratio as the total budget exclusive of Federal income tax, giving about $82 and $124, respectively.

13/ Budget from Estimated Weekly Cost of a Budget for an Employed Woman in the District of Columbia, mimeographed summary dated December 6, 1946, Women's Bureau, U. S. Department of Labor. It assumes that the woman obtains all her meals in restaurants. "The original budget was set up by a group of specialists and priced in the District of Columbia in 1937. The priced budget was modified by the D. C. Wage Board before adoption. Adjustments of the modified budget have been made [by the Women's Bureau] by use of BLS data." (Ibid.) This budget and the 3 following ones are not completely comparable, having been developed to meet special problems in connection with minimum wage rates.

14/ Includes savings provided at 10 percent of the cost of the total budget, or about $164.

15/ Budget from Estimated Annual Cost of Living for an Employed Woman Living Alone in Utah, March 1945, mimeographed summary dated February 15, 1947, Women's Bureau, U. S. Department of Labor. It assumes that the woman eats all her meals in a boarding house. "The original budget adopted by the Industrial Commission of Utah in 1939 was based on prices obtained in various cities and towns in Utah by the Women's Division, Industrial Commission. The 1945 figure is a revised estimate made by the U. S. Department of Labor, Bureau of Labor Statistics, by use of the Consumers' Price Index, plus the addition of relevant items ..." (Ibid.) These items were Federal and State income taxes not present in 1939, and the substitution of a 10-percent allowance for war bonds ($168) in place of the 1.5-percent "reserve for emergencies." The original budget included premiums for private insurance for which the March 1945 allowance is $41. (See also footnote 13, second paragraph.)

16/ Budget reported in Annual Cost of Adequate Maintenance and Protection of Health for a Woman Living as a Member of a Family Group in New York State, 1945, mimeographed summary dated February 15, 1947, Women's Bureau, U. S. Department of Labor. The budget is from the report of the cost of living for women workers, based on prices obtained by New York in 19 cities and towns as of October 15, 1945. The budget includes the woman's share of general family expenses including rent, household operation, and cost of mother's services, and cost of woman's lunches in restaurants.

17/ From tax table on Form 1040 for 1945. Summary shows combined amount of Federal and State income taxes without giving each separately.

18/ Includes savings of about $169 and that represented by $31 of private insurance premiums.

19/ Budget reported in Annual Cost of Minimum Budget of a Single Working Woman in Cities and Towns in Connecticut, March 1946, mimeographed summary dated February 15, 1947, Women's Bureau, U. S. Department of Labor, and "based on prices obtained by Connecticut in eleven cities and towns during February and March, 1946, for a woman living in a single room and eating all of her meals in restaurants." The budget as reported contains the item "Federal income tax (year, 1946), $188.00." In the budget in the present table this amount is replaced by $147, the amount given by the tax table in Form 1040 for 1946, and the Social Security tax (1 percent) and the total budget are adjusted accordingly. No allowances for insurance or other forms of saving are contained in the budget.

20/ United Steelworkers of America, The Steelworkers in 1943; An Income and Expenditure Study of Steelworkers' Families for September-November 1, 1943, p. 18, Table 25. See also footnotes 3 and 4 above.

21/ Includes total Federal, State and miscellaneous taxes estimated at $209 and savings consisting of $245 in war bonds and $32 in other forms.

22/ United Steelworkers of America, The Braddock Steelworker: An Income and Expenditure Study for January 1945 of Steelworkers in Braddock, Rankin and North Braddock, Pa. See also footnotes 3 and 4 above.

23/ Ibid., pp. 31, 32. Obtained by multiplying by 52 the sum of average family weekly expenditures of $57.01 and Federal taxes of $6.08.

24/ Ibid., p. 31.

Footnotes continued on p. 61.

Table 2

Recent available estimates of individual and family budgets and expenditures at various levels of living
(footnotes continued)

25/ Ibid., p. 33. Includes $384 ($7.38 weekly) of gross savings for average family, but contains no net savings (or deficit) on the average after taking account of those families, 45 percent of the total number, whose expenditures considerably exceed income.

26/ Source does not indicate whether data are obtained from budget or expenditure studies.

27/ Hearings before the Committee on Military Affairs, House of Representatives, 78th Congress, 1st. Sess. (S. 1279 et al.), Allowances and Allotments for Dependents of Military Personnel (Sept. 29-Oct. 5, 1943), pp. 139, 140. The National Lawyer's Guild proposal also includes an estimate of $960 per year as the recommended allotment for a wife without children or for one parent if dependent for chief portion of support on the allotment.

28/ The difference between the allowances for a wife alone and for a wife with one child is $480. The allowance for a child where there is no wife is $600. For each child after the first, the allowance is $240.

29/ The maintenance and emergency levels of family living were originally defined by the Works Progress Administration in its study, Intercity Differences in Cost of Living, March 1945, 59 Cities, Research Monograph No. XII, Washington, D. C., 1937. The maintenance level budget was made up of goods and services which the Works Progress Administration estimatedwere needed by a 4-person urban family of an unskilled manual worker living at a level which provided for bare current costs only, with no savings other than some life insurance. It was stated (page xiv of the Monograph) that this budget does not "approach the content of what may be considered a satisfactory American standard of living." The emergency level was constructed by making percentage cuts in the maintenance level which could be endured for but temporary periods. This level was recognized as constituting a health hazard if followed over an extended period of time.

Both levels were considered restricted standards by the Works Progress Administration which stated (p. xvii of the Monograph) "from the point of view of the long-time well-being of workers' families, a desirable standard of living would be one in which the concepts of maintenance and emergency have no place." See also footnote 3.

30/ Hearings before the Committee on Military Affairs, House of Representatives, 78th Cong., 1st Sess. (S. 1279 et al.) Allowances and Allotments for Dependents of Military Personnel (Sept. 29-Oct. 5, 1943), p. 60, Table 8. The data were presented in testimony by the Federal Security Agency and were obtained by applying BLS indexes of intercity differences to estimates made by the Consumer Income and Demand Branch of the Office of Price Administration of the cost of living for a wife and for a child at the maintenance level in San Francisco.

31/ Figures are based on data for a wife and 1, 2, or 3 children, which were compiled by the Bureau of Labor Statistics and presented on p. 67 of the Hearings cited in footnote 27. The average yearly maintenance costs for the 6 cities for May 1943 were as follows:

Wife, 1 child........................	$1,026
Wife, 2 children....................	1,268
Wife, 3 children....................	1,506

indicating that the increases in cost for the 2d and 3d child are fairly constant, about $240.

32/ Estimated Intercity Differences in Cost of Living, June 15, 1943, mimeographed release by the U. S. Bureau of Labor Statistics. The difference between the highest and lowest cost cities is about 21 percent. The variation from the average, however, is less than 11 percent. The data exclude war bonds and savings except for some life insurance. (See footnote 42.)

The figures shown give a comparison for various cities, in terms of June 1943 prices, based upon the standard "maintenance" level established by the Works Progress Administration (see footnote 29) and modified in 1938 to bring the food up to the level of the "adequate diet at minimum cost" of the United States Bureau of Home Economics. "The budget measures the cost of approximately the same level of living /for different cities/ and avoids differences caused by variations in income, habits, and customs." It "is not an official budget of the Department of Labor, nor does it represent a recommended standard of living." (Monthly Labor Review, U. S. Bureau of Labor Statistics, October 1943, pp. 803-804)

33/ The Bureau of Labor Statistics' latest mimeographed release, Relative Differences in the Cost of Equivalent Goods, Rents, and Services in 33 Large Cities, March 1945, dated June 1, 1946, gives the intercity indexes in terms of Washington, D. C. as a base. To convert these indexes to dollar amounts, the figure of $1,809 given in the preceding estimate (in the present table) for Washington, D. C. in June 1943 was converted to the March 1945 level by applying the percentage change in the BLS index for Washington from May 1943 to March 1945. (The percentage change May-June 1943 was insignificant.) The resulting figure of $1,844 was then used as a base and the other city indexes were applied to it, giving the amounts shown. The data indicate that the percentage difference between the highest and lowest cost cities is 17 percent, but the variation from the average index of 94.6 does not exceed 9 percent. It should be noted that the costs are only rough appraximations inasmuch as the BLS intercity relationships for 1943 are not on the same basis as for 1945, since the earlier ones represent the WPA maintenance level and the later ones give the relationships at the average income level -- a point much closer to the health and decency than to the maintenance standard.

34/ Textile Workers Union of America, Substandard Conditions of Living: A Study of the Cost of the Emergency Sustenance in Five Textile Manufacturing Communities in January-February 1944, New York, 1944, pp. 58-59. The content of the TWUA repriced subsistence budget differs from the WPA budget (estimated at $903 for a 4-person family in 1935) chiefly in an allowance of $162 for war bonds and the inclusion of $109 for food-buying habits to take into account the fact that shoppers cannot always buy most efficiently, especially during the period of war.

35/ Includes savings represented by $162 in war bonds and $21 in life insurance premiums.

Footnotes concluded on page 62.

Table 2 -

Recent available estimates of individual and family budgets and expenditures at various levels of living (footnotes concluded)

36/ University of California, The Heller Committee for Research in Social Economics, Quantity and Cost Budgets for Dependent Families or Children, Prices for San Francisco, September 1946. This study characterizes the budget standard in the following terms (pp. 3, 4): "In preparing this budget, the Heller Committee has attempted to maintain a standard which will preserve the health and efficiency of a dependent family and enable its children to grow up among their neighbors without being stigmatized. At the same time, the budget attempts to stay within the limits of the support that a welfare agency may reasonably be expected to provide. It is not in any sense a measurement of the minimum required to sustain life nor of the minimum on which families can subsist for brief periods of emergency when expenditures are limited to the bare essentials of food and shelter. The items and quantity allowances take into account not only physiological requirements but also certain customary living habits -- such as dietary preferences, tobacco, visits to the barber, an occasional movie -- which practical relief administrators recognize will be indulged at the expense of physiological requirements if no provision is made for them in a relief family's budget. In other words, it represents a standard at which the average housewife may be expected to manage her household and bring up her children to be good citizens if her income is derived from public relief." "Because the budget is designed for social dependents, no provision is made for insurance or savings, or for medical care, which must be furnished free by clinics." The Heller dependency standard thus may not be in all respects comparable to the WPA maintenance level but is much closer to it than to a "health and decency" standard, and hence is included under the more restricted category.

The figures shown here exclude income taxes as well as savings, and include Social Security (old-age and unemployment insurance) taxes of 2 percent calculated on a total budget that includes these taxes, in cases where an individual is employed.

37/ In the absence of more suitable data, the instructions of the Heller Committee for computing a dependency budget for a child in a foster home have been followed in the dependency budgets for children used here. These instructions are to take his per capita share of the allowance for rent for a family of appropriate size, general household expenses, and other overhead expenses allowed as a flat sum to all families, regardless of size, and add his additional allowance for other expenses determined with reference to age and sex. (This additional allowance, however, excludes medical and dental expenses as this care is supposed to be given by free clinics. (See footnote 36.)) The resulting budgets for dependent children, therefore, consist partly of overhead items averaged over all members of the household, and partly of additional expenses attributable to the addition of a child to the household. It should, however, be pointed out that inasmuch as the level of dependent exemptions involves considerations of cost for the marginal, i.e., added dependent, a sounder theoretical method would be to determine how much additional allowance for expenses is necessary with respect to an additional child for each size of family, rather than the average allowance on a per person basis without reference to family size, used for some of the items.

38/ Allowances are for an employed individual 18-20 years old living as a member of a 4-person family. The first figure is the amount allowed for a boy; the second, for a girl. See also footnote 36.

39/ Allowances are for a nonworking family member in a family of 4, the smaller amount being for a child of 1 - 2 years and the larger amount for a boy 15 - 17. See also footnote 36.

40/ Rent is taken as that for a 3-person family ($25.25) since data are not available for a couple.

41/ Rough estimate made by adding to the budget of $1,161 an allowance of $80 consisting of items for medical care, life insurance, and the increase in Social Security taxes on the higher budget amount. The medical and insurance items are taken as one-half the WPA allowances for a 4-person family in March 1935 brought up to date by price indexes. See footnote 42.

42/ Rough estimate made by adding approximately $163 to the budget of $1,782 to cover allowances for medical care, life insurance and the increase in Social Security taxes based on the increased budget. The medical and insurance items are obtained by using the BLS consumers' price index (miscellaneous group) for San Francisco to bring the WPA March 1935 allowances of $64 for medical care and $46 for insurance up to September 1946 price levels.

43/ Adjustment made by applying to each budget figure in estimate 5a above, the percentage change in the consumers' price index for San Francisco from September 1946 to September 1947.

44/ The "break-even point," as defined by the Bureau of Labor Statistics, is that amount of total family income, after subtraction of income, poll, and personal property taxes, just sufficient to cover average expenditures for current consumption and gifts and contributions, leaving no net savings or deficit. The amounts needed were computed by linear interpolation in the family-size tables of the BLS printed release entitled Expenditures and Savings of City Families in 1944, Serial No. R. 1818. The break-even data shown here exhibit increasing irregularity with respect to larger families since these families are of less frequent occurrence and the sample data from the expenditure survey are necessarily less reliable with respect to groups of rare occurrence.

45/ Family Spending and Saving in Wartime, Bulletin No. 822, U. S. Bureau of Labor Statistics, Table 19, pp. 102, 104.

46/ Personal tax payments for families at the break-even point were negligible ($2 or less) for all family sizes.

47/ Break-even point computed for families of 5 or more.

48/ Expenditures and Savings of City Families in 1944, BLS printed release, Serial No. R. 1818, U. S. Bureau of Labor Statistics, Tables 3 and 4.

Table 3

Estimated combined normal tax and surtax liability under present law 1/ and under various exemptions assuming present law rates, distributed by net income classes, in calendar year 1947

(assuming income payments of $166 billion) 2/

Net income classes ($000)	Exemptions for single persons, married couples and dependents, respectively					
	$500, $1,000, $500 (present law)		$600, $1,200, $600		$700, $1,400, $700	
	Amount	Percent	Amount	Percent	Amount	Percent
	(amounts in millions)					
Under 1	$ 299.5	1.8%	$ 179.5	1.2%	$ 105.2	.8%
1 - 2	2,839.6	17.0	2,332.5	15.5	1,923.8	14.1
2 - 3	3,692.3	22.1	3,134.1	20.8	2,659.6	19.5
3 - 4	1,827.7	10.9	1,585.8	10.5	1,368.8	10.0
4 - 5	775.9	4.6	696.5	4.6	621.2	4.5
Under 5	9,435.0	56.5	7,928.4	52.7	6,678.6	48.9
5 - 10	1,318.0	7.9	1,244.3	8.3	1,171.6	8.6
10 - 25	1,864.5	11.2	1,819.4	12.1	1,774.8	13.0
25 - 50	1,365.7	8.2	1,352.3	9.0	1,338.9	9.8
50 - 100	1,117.7	6.7	1,112.6	7.4	1,107.3	8.1
100 - 250	835.1	5.0	833.4	5.5	831.8	6.1
250 - 500	290.5	1.7	290.3	1.9	290.0	2.1
500 - 1,000	212.5	1.3	212.5	1.4	212.4	1.6
1,000 and over	253.0	1.5	253.0	1.7	253.0	1.9
5,000 and over	7,257.0	43.5	7,117.7	47.3	6,979.8	51.1
Total	16,692.0	100.0	15,046.1	100.0	13,658.3	100.0

Continued on next page

Footnotes on next page

Table 3 - concluded

Estimated combined normal tax and surtax liability under present law 1/ and under various exemptions assuming present law rates, distributed by net income classes, in calendar year 1947

(assuming income payments of $166 billion) 2/

Net income classes ($000)	Exemptions for single persons, married couples and dependents, respectively							
	$800, $1,200, $400 3/		$800, $1,600, $400 4/		$1,000, $1,500, $500 3/		$1,000, $2,000, $500 4/	
	Amount	Per-cent	Amount	Per-cent	Amount	Per-cent	Amount	Per-cent
Under 1	$ 134.2	.9%	$ 46.4	.3%	$ 69.8	.5%	$ 2.2	*
1 - 2	2,085.0	13.8	1,615.6	12.1	1,400.6	10.8	1,048.8	9.3%
2 - 3	3,306.8	21.8	2,578.7	19.3	2,518.2	19.4	1,805.1	16.0
3 - 4	1,718.0	11.3	1,446.2	10.8	1,388.5	10.7	1,076.2	9.5
4 - 5	745.1	4.9	660.4	4.9	638.5	4.9	536.3	4.8
Under 5	7,989.1	52.7	6,347.3	47.4	6,015.7	46.3	4,468.5	39.6
5 - 10	1,279.6	8.4	1,199.1	9.0	1,177.5	9.1	1,081.5	9.6
10 - 25	1,834.7	12.2	1,790.7	13.4	1,770.8	13.7	1,717.2	15.2
25 - 50	1,355.1	8.9	1,346.9	10.1	1,335.7	10.3	1,325.5	11.8
50 - 100	1,113.3	7.3	1,110.7	8.3	1,105.8	8.5	1,102.6	9.8
100 - 250	833.5	8.5	832.8	6.2	831.0	6.4	830.2	7.4
250 - 500	290.3	1.9	290.2	2.2	290.0	2.2	289.8	2.6
500 - 1,000	212.5	1.4	212.5	1.6	212.4	1.6	212.3	1.9
1,000 and over	253.0	1.7	253.0	1.9	253.0	1.9	253.0	2.2
5,000 and over	7,172.0	47.3	7,035.9	52.6	6,976.2	53.7	6,812.1	60.4
Total	15,161.1	100.0	13,383.2	100.0	12,991.9	100.0	11,280.6	100.0

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1/ Internal Revenue Code, as amended by Revenue Act of 1945.

2/ The definition of income payments used here is the unrevised concept. See "National Income Supplement to Survey of Current Business," July 1947. The current level of income payments is substantially higher than the $166 billion level assumed when these estimates were prepared. The higher level of income payments would raise appreciably the amounts of the revenue losses involved.

3/ Assuming that married persons filing separate returns would split their exemptions so that one spouse takes the exemption for a single person and the other the exemption for a dependent.

4/ Assuming the first dependent of a single person would qualify the single person as a head of family, entitled to a married couple's exemption.

* Less than 0.05 percent.

Note: Figures are rounded and will not necessarily add to totals.

Source: Office of the Technical Staff, Treasury Department.

Table 4

Comparison of individual income taxes under present law 1/ in the United States, United Kingdom and Canada

Single person - No dependents

Net income before personal exemption	United States		United Kingdom 2/		Canada 3/			
					1947 4/		1948	
	Amount of tax	Effective rate	Amount of tax	Effective rate	Amount of tax	Effective rate	Amount of tax	Effective rate
$ 500	-	-	-	-	-	-	-	-
600	$ 19	3.2%	$ 9	1.5%	-	-	-	-
800	57	7.1	38	4.8	$ 8	1.0%	$ 5	.6%
1,000	95	9.5	88	8.8	42	4.2	29	2.9
1,500	190	12.7	260	17.3	150	10.0	120	8.0
2,000	285	14.3	447	22.4	267	13.4	220	11.0
3,000	485	16.2	822	27.4	507	16.9	420	14.0
4,000	694	17.3	1,197	29.9	758	19.0	620	15.5
5,000	922	18.4	1,572	31.4	1,020	20.4	835	16.7
6,000	1,169	19.5	1,947	32.5	1,302	21.7	1,065	17.8
8,000	1,720	21.5	2,847	35.6	1,932	24.2	1,615	20.2
10,000	2,347	23.5	3,947	39.5	2,646	26.5	2,253	22.5
15,000	4,270	28.5	6,972	46.5	4,746	31.6	4,153	27.7
25,000	9,362	37.5	13,972	55.9	9,833	39.3	9,015	36.1
50,000	25,137	50.3	34,847	69.7	24,774	49.5	23,456	46.9
100,000	63,541	63.5	82,597	82.6	59,324	59.3	56,631	56.6
250,000	191,772	76.7	228,847	91.5	178,999	71.6	172,556	69.0
500,000	407,897	81.6	472,597	94.5	395,211	79.0	382,518	76.5
750,000	624,022	83.2	716,347	95.5	611,461	81.5	592,518	79.0
1,000,000	840,147	84.0	960,097	96.0	827,711	82.8	802,518	80.3

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Footnotes on next page.

Table 4 - concluded

Comparison of individual income taxes under present law 1/ in the United States, United Kingdom and Canada

Footnotes:

1/ United States Internal Revenue Code, as amended by the Revenue Act of 1945, applicable to 1946 and subsequent years; British Finance Acts (No. 2) 1945, 1946 and 1947, applicable to the year 1947-48; Canadian Income War Tax Act, as amended by Chapter 55, Statutes of 1946, and Chapter 63, Statutes of 1947, applicable to 1947 and subsequent years.

2/ Maximum earned net income assumed. Pound converted at $4.

3/ All income in excess of $30,000 is assumed to be investment income.

4/ The Canadian tax for 1947 was calculated by applying the rates which went into effect on January 1, 1947 to half of the taxpayer's income for the year and the new rates, which went into effect on July 1, 1947 to the other half; in other words, the tax for the year as a whole is the average of the two sets of rates.

Table 4a

Comparison of individual income taxes under present law 1/ in the United States, United Kingdom and Canada

Married person - No dependents

Net income before personal exemption	United States		United Kingdom 2/		Canada 3/			
					1947 4/		1948	
	Amount of tax	Effective rate	Amount of tax	Effective rate	Amount of tax	Effective rate	Amount of tax	Effective rate
$ 800	-	-	-	-	-	-	-	-
1,000	-	-	$ 17	1.7%	-	-	-	-
1,500	$ 95	6.3%	134	8.9	-	-	-	-
2,000	190	9.5	321	16.1	$ 94	4.7%	$ 70	3.5%
3,000	380	12.7	696	23.2	327	10.9	270	9.0
4,000	589	14.7	1,071	26.8	567	14.2	470	11.8
5,000	798	16.0	1,446	28.9	822	16.4	670	13.4
6,000	1,045	17.4	1,821	30.4	1,087	18.1	890	14.8
8,000	1,577	19.7	2,721	34.0	1,677	21.0	1,390	17.4
10,000	2,185	21.9	3,821	38.2	2,357	23.6	1,990	19.9
15,000	4,047	27.0	6,846	45.6	4,402	29.3	3,840	25.6
25,000	9,082	36.3	13,846	55.4	9,439	37.8	8,640	34.6
50,000	24,795	49.6	34,721	69.4	24,342	48.7	23,043	46.1
100,000	63,128	63.1	82,471	82.5	58,817	58.8	56,143	56.1
250,000	191,340	76.5	228,721	91.5	178,417	71.4	171,993	68.8
500,000	407,465	81.5	472,471	94.5	394,592	78.9	381,918	76.4
750,000	623,590	83.2	716,221	95.5	610,842	81.4	591,918	78.9
1,000,000	839,715	84.0	959,971	96.0	827,092	82.7	801,918	80.2

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Footnotes on next page.

Table 4a - concluded

Comparison of individual income taxes under present law 1/ in the United States, United Kingdom and Canada

Footnotes

1/ United States Internal Revenue Code, as amended by the Revenue Act of 1945, applicable to 1946 and subsequent years; British Finance Acts (No. 2) 1945, 1946 and 1947, applicable to the year 1947-48; Canadian Income War Tax Act, as amended by Chapter 55, Statutes of 1946, and Chapter 63, Statutes of 1947, applicable to 1947 and subsequent years.

2/ Maximum earned net income assumed. Pound converted at $4.

3/ All income in excess of $30,000 is assumed to be investment income.

4/ The Canadian tax for 1947 was calculated by applying the rates which went into effect on January 1, 1947 to half of the taxpayer's income for the year and the new rates, which went into effect on July 1, 1947 to the other half; in other words, the tax for the year as a whole is the average of the two sets of rates.

Table 4b

Comparison of individual income taxes under present law 1/ in the United States, United Kingdom and Canada

Married person - Two dependents

Net income before personal exemption	United States		United Kingdom 2/ 4/		Canada 3/ 4/			
					1947 5/		1948	
	Amount of tax	Effective rate	Amount of tax	Effective rate	Amount of tax	Effective rate	Amount of tax	Effective rate
$ 1,200	-	-	$ - 52	- 4.3%	$ - 144	- 12.0%	$ - 144	- 12.0%
1,500	-	-	- 38	- 2.5	- 144	- 9.6	- 144	- 9.6
2,000	-	-	73	3.7	- 92	- 4.6	- 108	- 5.4
3,000	$ 190	6.3%	448	14.9	134	4.5	86	2.9
4,000	380	9.5	823	20.6	374	9.4	286	7.2
5,000	589	11.8	1,198	24.0	626	12.5	486	9.7
6,000	798	13.3	1,576	26.3	889	14.8	702	11.7
8,000	1,292	16.2	2,482	31.0	1,473	18.4	1,194	14.9
10,000	1,862	18.6	3,583	35.8	2,144	21.4	1,786	17.9
15,000	3,639	24.3	6,611	44.1	4,168	27.8	3,616	24.1
25,000	8,522	34.1	13,618	54.5	9,190	36.8	8,396	33.6
50,000	24,111	48.2	34,501	69.0	24,083	48.2	22,789	45.6
100,000	62,301	62.3	82,254	82.3	58,538	58.5	55,869	55.9
250,000	190,475	76.2	228,504	91.4	178,118	71.2	171,699	68.7
500,000	406,600	81.3	472,254	94.5	394,283	78.9	381,614	76.3
750,000	622,725	83.0	716,004	95.5	610,533	81.4	591,614	78.9
1,000,000	838,850	83.9	959,754	96.0	826,783	82.7	801,614	80.2

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1/ United States Internal Revenue Code, as amended by the Revenue Act of 1945, applicable to 1946 and subsequent years; British Finance Acts (No. 2) 1945, 1946 and 1947, applicable to the year 1947-48; Canadian Income War Tax Act, as amended by Chapter 55, Statutes of 1946, and Chapter 63, Statutes of 1947, applicable to 1947 and subsequent years.

Footnotes continued on next page.

Table 4b - concluded

Comparison of individual income taxes under present law 1/ in the United States, United Kingdom and Canada

Footnotes

2/ Maximum earned net income assumed. Pound converted at $4.
3/ All income in excess of $30,000 is assumed to be investment income. In accordance with Canadian treatment, taxable income does not include family allowances.
4/ United Kingdom and Canadian tax figures represent the net position of a taxpayer with one child and two children, respectively, of family allowance age, reflecting the combined effect of receipt of family allowances and payment of income tax. Minus signs indicate that family allowances exceed the income tax by the amounts shown. For detail, see Table 4c, p. 71.
5/ The Canadian tax for 1947 was calculated by applying the rates which went into effect on January 1, 1947 to half of the taxpayer's income for the year and the new rates, which went into effect on July 1, 1947 to the other half; in other words, the tax for the year as a whole is the average of the two sets of taxes.

Table 4c

Comparison of family allowances, income taxes, and the combined effect of receipt of family allowances and payment of income tax in the United Kingdom for 1947-48 and Canada for 1947 1/

Married person - Two dependents

Net income before personal exemptions and family allowances	Family allowances 2/		United Kingdom 3/			Canada 4/			Effective rates based on net position 6/	
	United Kingdom	Canada	Income tax	Offset for family allowances 5/	Net position 6/	Income tax 7/	Offset for family allowances	Net position 6/	United Kingdom	Canada
$ 1,200	$ 52	$ 144	-	$ 52	$ - 52	-	$ 144	$ - 144	- 4.3 %	- 12.0 %
1,500	52	144	$ 8	46	- 38	-	144	- 144	- 2.5	- 9.6
2,000	52	144	110	38	73	$ 52	144	- 92	3.7	- 4.6
3,000	52	144	480	33	448	278	144	134	14.9	4.5
4,000	52	144	855	33	823	518	144	374	20.6	9.4
5,000	52	144	1,230	33	1,198	770	144	626	24.0	12.5
6,000	52	144	1,605	29	1,576	1,033	144	889	26.3	14.8
8,000	52	144	2,505	23	2,482	1,617	144	1,473	31.0	18.4
10,000	52	144	3,605	22	3,583	2,288	144	2,144	35.8	21.4
15,000	52	144	6,630	20	6,611	4,312	144	4,168	44.1	27.8
25,000	52	144	13,630	12	13,618	9,334	144	9,190	54.5	36.8
50,000	52	144	34,505	4	34,501	24,227	144	24,083	69.0	48.2
100,000	52	144	82,255	1	82,254	58,682	144	58,538	82.3	58.5
250,000	52	144	228,505	1	228,504	178,262	144	178,118	91.4	71.2
500,000	52	144	472,255	1	472,254	394,427	144	394,283	94.5	78.9
750,000	52	144	716,005	1	716,004	610,677	144	610,533	95.5	81.4
1,000,000	52	144	959,755	1	959,754	826,927	144	826,783	96.0	82.7

Treasury Department, Division of Tax Research

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Table 4c - concluded

Comparison of family allowances, income taxes, and the combined effect of receipt of family allowances and payment of income tax in the United Kingdom for 1947-48 and Canada for 1947 1/

Married person - Two dependents

Footnotes:

1/ British Finance Acts (No. 2) 1945, 1946, and 1947 applicable to the year 1947-48; Canadian Income War Tax Act, as amended by Chapter 55, Statutes of 1946, and Chapter 63, Statutes of 1947, applicable to 1947 and subsequent years.

2/ For the United Kingdom, assumes one child eligible for family allowance payments provided under the Family Allowances Act, 1945, payable at the rate of $1 per week for each child, other than the eldest, under 16 years of age. Under the British Finance Act of 1946, family allowances are subject to income tax. For Canada, assumes family allowance payments of $72 for each child.

3/ Maximum earned net income assumed; income tax figures represent the tax on net income before family allowances. Pound converted at $4.

4/ All income in excess of $30,000 is assumed to be investment income. In accordance with Canadian treatment, taxable income does not include family allowances. For 1947 and subsequent years, the dependent deduction allowed for income tax purposes for each child eligible to receive family allowances is $100.

5/ Net family allowance benefit after income tax.

6/ Minus signs indicate that the net family allowance exceeds the income tax by the amounts shown.

7/ The Canadian tax for 1947 was calculated by applying the rates which went into effect on January 1, 1947 to half of the taxpayers' income for the year and the new rates which went into effect on July 1, 1947, to the other half; in other words, the tax for the year as a whole is the average of the two sets of taxes.

Note: Figures are rounded and will not necessarily add to totals.

Table 5

Comparison of amounts and effective rates of individual income tax under present law 1/ and under various exemption systems, for specified amounts of net income

Single person - No dependents

Net income before personal exemption	Amounts of tax				
	$500 exemption (present law)	$600 2/ exemption	$700 3/ exemption	$800 4/ exemption	$1,000 5/ exemption
$500	-	-	-	-	-
600	$19	-	-	-	-
800	57	$38	$19	-	-
1,000	95	76	57	$38	-
1,500	190	171	152	133	$95
2,000	285	266	247	228	190
3,000	485	464	443	422	380
4,000	694	673	652	631	589
5,000	922	897	872	847	798
6,000	1,169	1,144	1,119	1,094	1,045
8,000	1,720	1,691	1,663	1,634	1,577
10,000	2,347	2,314	2,282	2,250	2,185
15,000	4,270	4,226	4,181	4,136	4,047
25,000	9,362	9,306	9,250	9,194	9,082
50,000	25,137	25,069	25,000	24,932	24,795
100,000	63,541	63,458	63,375	63,293	63,128
500,000	407,897	407,810	407,724	407,637	407,465
1,000,000	840,147	840,060	839,974	839,887	839,715
5,000,000	4,275,000 6/	4,275,000 6/	4,275,000 6/	4,275,000 6/	4,275,000 6/

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Table 5 - concluded

Comparison of amounts and effective rates of individual income tax under present law 1/ and under various exemption systems, for specified amounts of net income

Single person - No dependents

Net income before personal exemption	Effective rates				
	$500 exemption (present law)	$600 2/ exemption	$700 3/ exemption	$800 4/ exemption	$1,000 5/ exemption
$500	-	-	-	-	-
600	3.2%	-	-	-	-
800	7.1	4.8%	2.4%	-	-
1,000	9.5	7.6	5.7	3.8%	-
1,500	12.7	11.4	10.1	8.9	6.3%
2,000	14.3	13.3	12.4	11.4	9.5
3,000	16.2	15.5	14.8	14.1	12.7
4,000	17.3	16.8	16.3	15.8	14.7
5,000	18.4	17.9	17.4	17.0	16.0
6,000	19.5	19.1	18.7	18.2	17.4
8,000	21.5	21.1	20.8	20.4	19.7
10,000	23.5	23.1	22.8	22.5	21.9
15,000	28.5	28.2	27.9	27.6	27.0
25,000	37.5	37.2	37.0	36.8	36.3
50,000	50.3	50.1	50.0	49.9	49.6
100,000	63.5	63.5	63.4	63.3	63.1
500,000	81.6	81.6	81.5	81.5	81.5
1,000,000	84.0	84.0	84.0	84.0	84.0
5,000,000	85.5	85.5	85.5	85.5	85.5

Treasury Department, Division of Tax Research

Note: Computations were made from unrounded figures and will not necessarily agree with figures computed from the rounded amounts and percentages shown.

1/ Internal Revenue Code, as amended by Revenue Act of 1945.
2/ Exemption under level of $600 per capita.
3/ Exemption under level of $700 per capita.
4/ Exemption under levels for single persons, married couples and dependents, respectively, of $800, $1,600, $400 (Combination A), and $800, $1,200, $400 (Combination B).
5/ Exemption under levels for single persons, married couples and dependents, respectively, of $1,000, $2,000, $500 (Combination A), and $1,000, $1,500, $500 (Combination B).
6/ Taking into account maximum effective rate limitation of 85.5 percent.

Table 5a

Decrease in amounts and effective rates of individual income tax under various exemption systems compared with present law 1/ and tax decrease as a percentage of present tax liability, for specified amounts of net income

Single person -- No dependents

Net income before personal exemption	Decrease in amounts of tax compared with present law			
	$600 exemption 2/	$700 exemption 3/	$800 exemption 4/	$1,000 exemption 5/
$500	-	-	-	-
600	$19	$19	$19	$19
800	19	38	57	57
1,000	19	38	57	95
1,500	19	38	57	95
2,000	19	38	57	95
3,000	21	42	63	105
4,000	21	42	63	105
5,000	25	49	74	124
6,000	25	49	74	124
8,000	29	57	86	143
10,000	32	65	97	162
15,000	45	89	134	223
25,000	56	112	168	280
50,000	68	137	205	342
100,000	83	165	248	413
500,000	86	173	259	432
1,000,000	86	173	259	432
5,000,000	-	-	-	-

Net income before personal exemption	Decrease in effective rates compared with present law			
	$600 exemption 2/	$700 exemption 3/	$800 exemption 4/	$1,000 exemption 5/
$500	-	-	-	-
600	3.2%	3.2%	3.2%	3.2%
800	2.4	4.8	7.1	7.1
1,000	1.9	3.8	5.7	9.5
1,500	1.3	2.5	3.8	6.3
2,000	1.0	1.9	2.9	4.8
3,000	.7	1.4	2.1	3.5
4,000	.5	1.1	1.6	2.6
5,000	.5	1.0	1.5	2.5
6,000	.4	.8	1.2	2.1
8,000	.4	.7	1.1	1.8
10,000	.3	.7	1.0	1.6
15,000	.3	.6	.9	1.5
25,000	.2	.5	.7	1.1
50,000	.1	.3	.4	.7
100,000	.1	.2	.3	.4
500,000	*	*	.1	.1
1,000,000	*	*	*	*
5,000,000	-	-	-	-

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Table 5a - concluded

Decrease in amounts and effective rates of individual income tax under various exemption systems compared with present law 1/ and tax decrease as a percentage of present tax liability, for specified amounts of net income

Single person - No dependents

Net income before personal exemption	Tax decrease as a percentage of present tax liability: $600 exemption 2/	$700 exemption 3/	$800 exemption 4/	$1,000 exemption 5/
$500 -	-	-	-	-
600	100.0%	100.0%	100.0%	100.0%
800	33.3	66.7	100.0	100.0
1,000	20.0	40.0	60.0	100.0
1,500	10.0	20.0	30.0	50.0
2,000	6.7	13.3	20.0	33.3
3,000	4.3	8.6	12.9	21.6
4,000	3.0	6.0	9.0	15.1
5,000	2.7	5.4	8.0	13.4
6,000	2.1	4.2	6.3	10.6
8,000	1.7	3.3	5.0	8.3
10,000	1.4	2.8	4.1	6.9
15,000	1.1	2.1	3.1	5.2
25,000	.6	1.2	1.8	3.0
50,000	.3	.5	.8	1.4
100,000	.1	.3	.4	.7
500,000	*	*	.1	.1
1,000,000	*	*	*	.1
5,000,000	-	-	-	-

Treasury Department, Division of Tax Research

Note: Computations were made from unrounded figures and will not necessarily agree with figures computed from the rounded amounts and percentages shown.

1/ Internal Revenue Code, as amended by Revenue Act of 1945.

2/ Exemption under level of $600 per capita.

3/ Exemption under level of $700 per capita.

4/ Exemption under levels for single persons, married couples and dependents, respectively, of $800, $1,600, $400 (Combination A), and $800, $1,200, $400 (Combination B).

5/ Exemption under levels for single persons, married couples and dependents, respectively, of $1,000, $2,000, $500 (Combination A), and $1,000, $1,500, $500 (Combination B).

* Less than 0.05 percent.

Table 5b

Comparison of amounts and effective rates of individual income tax under present law 1/ and under various exemption systems, for specified amounts of net income

Married person - No dependents

Net income before personal exemption	Amounts of tax					
	$1,000 exemption (present law)	$1,200 exemption 2/	$1,400 exemption 3/	$1,500 exemption 4/	$1,600 exemption 5/	$2,000 exemption 6/
$ 1,000	-	-	-	-	-	-
1,500	$ 95	$ 57	$ 19	-	-	-
2,000	190	152	114	$ 95	$ 767	-
3,000	380	342	304	285	266	$ 190
4,000	589	547	505	485	464	380
5,000	798	756	714	694	673	589
6,000	1,045	996	946	922	897	798
8,000	1,577	1,520	1,463	1,435	1,406	1,292
10,000	2,185	2,120	2,056	2,024	1,991	1,862
15,000	4,047	3,965	3,884	3,843	3,802	3,639
25,000	9,082	8,970	8,858	8,802	8,746	8,522
50,000	24,795	24,658	24,521	24,453	24,385	24,111
100,000	63,128	62,962	62,797	62,714	62,632	62,301
500,000	407,465	407,292	407,119	407,032	406,946	406,600
1,000,000	839,715	839,542	839,369	839,282	839,196	838,850
5,000,000	4,275,000 7/	4,275,000 7/	4,275,000 7/	4,275,000 7/	4,275,000 7/	4,275,000 7/

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Table 5b - concluded

Comparison of amounts and effective rates of individual income tax under present law 1/ and under various exemption systems, for specified amounts of net income

Married person - No dependents

Net income before personal exemption	Effective rates					
	$1,000 exemption (present law)	$1,200 exemption 2/	$1,400 exemption 3/	$1,500 exemption 4/	$1,600 exemption 5/	$2,000 exemption 6/
$1,000	-	-	-	-	-	-
1,500	6.3%	3.8%	1.3%	-	-	-
2,000	9.5	7.6	5.7	4.8%	3.8%	-
3,000	12.7	11.4	10.1	9.5	8.9	6.3%
4,000	14.7	13.7	12.6	12.1	11.6	9.5
5,000	16.0	15.1	14.3	13.9	13.5	11.8
6,000	17.4	16.6	15.8	15.4	15.0	13.3
8,000	19.7	19.0	18.3	17.9	17.6	16.2
10,000	21.9	21.2	20.6	20.2	19.9	18.6
15,000	27.0	26.4	25.9	25.6	25.4	24.3
25,000	36.3	35.9	35.4	35.2	35.0	34.1
50,000	49.6	49.3	49.0	48.9	48.8	48.2
100,000	63.1	63.0	62.8	62.7	62.6	62.3
500,000	81.5	81.5	81.4	81.4	81.4	81.3
1,000,000	84.0	84.0	83.9	83.9	83.9	83.9
5,000,000	85.5	85.5	85.5	85.5	85.5	85.5

Treasury Department, Division of Tax Research

Note: Computations were made from unrounded figures and will not necessarily agree with figures computed from the rounded amounts and percentages shown.

1/ Internal Revenue Code, as amended by Revenue Act of 1945.
2/ Exemption under $600 per capita and under levels of $800 for single persons, $1,200 for married couples, and $400 for dependents (Combination B).
3/ Exemption under level of $700 per capita.
4/ Exemption under levels of $1,000 for single persons, $1,500 for married couples, and $500 for dependents (Combination B).
5/ Exemption under levels of $800 for single persons, $1,600 for married couples, and $400 for dependents (Combination A).
6/ Exemption under levels of $1,000 for single persons, $2,000 for married couples, and $500 for dependents (Combination A).
7/ Taking into account maximum effective rate limitation of 85.5 percent.

Table 5c

Decrease in amounts and effective rates of individual income tax under various exemption systems compared with present law 1/ and tax decrease as a percentage of present tax liability, for specified amounts of net income

Married person - No dependents

Net income before personal exemption	Decrease in amounts of tax compared with present law: $1,200 exemption 2/	$1,400 exemption 3/	$1,500 exemption 4/	$1,600 exemption 5/	$2,000 exemption 6/
$1,000	-	-	-	-	-
1,500	$38	$76	$95	$95	$95
2,000	38	76	95	114	190
3,000	38	76	95	114	190
4,000	42	84	105	125	209
5,000	42	84	105	125	209
6,000	49	99	124	148	247
8,000	57	114	143	171	285
10,000	65	129	162	194	323
15,000	82	163	204	245	409
25,000	112	224	280	336	561
50,000	137	274	342	410	684
100,000	165	331	413	496	827
500,000	173	346	432	519	865
1,000,000	173	346	432	519	865
5,000,000	-	-	-	-	-

Net income before personal exemption	Decrease in effective rates compared with present law: $1,200 exemption 2/	$1,400 exemption 3/	$1,500 exemption 4/	$1,600 exemption 5/	$2,000 exemption 6/
$1,000	-	-	-	-	-
1,500	2.5%	5.1%	6.3%	6.3%	6.3%
2,000	1.9	3.8	4.8	5.7	9.5
3,000	1.3	2.5	3.2	3.8	6.3
4,000	1.1	2.1	2.6	3.1	5.2
5,000	.8	1.7	2.1	2.5	4.2
6,000	.8	1.7	2.1	2.5	4.1
8,000	.7	1.4	1.8	2.1	3.6
10,000	.7	1.3	1.6	1.9	3.2
15,000	.5	1.1	1.4	1.6	2.7
25,000	.5	.9	1.1	1.4	2.2
50,000	.3	.6	.7	.8	1.4
100,000	.2	.3	.4	.5	.8
500,000	*	.1	.1	.1	.2
1,000,000	*	*	*	.1	.1
5,000,000	-	-	-	-	-

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Table 5c.- concluded

Decrease in amounts and effective rates of individual income tax under various exemption systems compared with present law 1/ and tax decrease as a percentage of present tax liability, for specified amounts of net income

Married person - No dependents

Net income before personal exemption	Tax decrease as a percentage of present tax liability				
	$1,200 exemption 2/	$1,400 exemption 3/	$1,500 exemption 4/	$1,600 exemption 5/	$2,000 exemption 6/
$ 1,000	-	-	-	-	-
1,500	40.0%	80.0%	100.0%	100.0%	100.0%
2,000	20.0	40.0	50.0	60.0	100.0
3,000	10.0	20.0	25.0	30.0	50.0
4,000	7.1	14.2	17.7	21.3	35.5
5,000	5.2	10.5	13.1	15.7	26.2
6,000	4.7	9.5	11.8	14.2	23.6
8,000	3.6	7.2	9.0	10.8	18.1
10,000	3.0	5.9	7.4	8.9	14.8
15,000	2.0	4.0	5.1	6.1	10.1
25,000	1.2	2.5	3.1	3.7	6.2
50,000	.6	1.1	1.4	1.7	2.8
100,000	.3	.5	.7	.8	1.3
500,000	*	.1	.1	.1	.2
1,000,000	*	*	.1	.1	.1
5,000,000	-	-	-	-	-

Treasury Department, Division of Tax Research

Note: Computations were made from unrounded figures and will not necessarily agree with figures computed from the rounded amounts and percentages shown.

1/ Internal Revenue Code, as amended by Revenue Act of 1945.
2/ Exemption under $600 per capita and under levels of $800 for single persons, $1,200 for married couples, and $400 for dependents (Combination B).
3/ Exemption under level of $700 per capita.
4/ Exemption under levels of $1,000 for single persons, $1,500 for married couples, and $500 for dependents (Combination B).
5/ Exemption under levels of $800 for single persons, $1,600 for married couples, and $400 for dependents (Combination A).
6/ Exemption under levels of $1,000 for single persons, $2,000 for married couples, and $500 for dependents (Combination A).

* Less than 0.05 percent.

Table 5d

Comparison of amounts and effective rates of individual income tax under present law 1/ and under various exemption systems, for specified amounts of net income

Married person - Two dependents

Net income before personal exemption	Amounts of tax				
	$2,000 exemption (present law) 2/	$2,400 exemption 3/	$2,500 exemption 4/	$2,800 exemption 5/	$3,000 exemption 6/
$2,000	-	-	-	-	
3,000	$190	$114	$95	$38	-
4,000	380	304	285	228	$190
5,000	589	505	485	422	380
6,000	798	714	694	631	589
8,000	1,292	1,193	1,169	1,094	1,045
10,000	1,862	1,748	1,720	1,634	1,577
15,000	3,639	3,475	3,434	3,312	3,230
25,000	8,522	8,297	8,241	8,073	7,961
50,000	24,111	23,837	23,769	23,564	23,427
100,000	62,301	61,970	61,888	61,640	61,475
500,000	406,600	406,254	406,168	405,908	405,736
1,000,000	838,850	838,504	838,418	838,158	837,986
5,000,000	4,275,000 7/	4,275,000 7/	4,275,000 7/	4,275,000 7/	4,275,000 7/

Net income before personal exemption	Effective rates				
	$2,000 exemption (present law) 2/	$2,400 exemption 3/	$2,500 exemption 4/	$2,800 exemption 5/	$3,000 exemption 6/
$2,000	-	-	-	-	-
3,000	6.3%	3.8%	3.2%	1.3%	-
4,000	9.5	7.6	7.1	5.7	4.8%
5,000	11.8	10.1	9.7	8.4	7.6
6,000	13.3	11.9	11.6	10.5	9.8
8,000	16.2	14.9	14.6	13.7	13.1
10,000	18.6	17.5	17.2	16.3	15.8
15,000	24.3	23.2	22.9	22.1	21.5
25,000	34.1	33.2	33.0	32.3	31.8
50,000	48.2	47.7	47.5	47.1	46.9
100,000	62.3	62.0	61.9	61.6	61.5
500,000	81.3	81.3	81.2	81.2	81.2
1,000,000	83.9	83.9	83.8	83.8	83.8
5,000,000	85.5	85.5	85.5	85.5	85.5

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Table 5d - concluded

Comparison of amounts and effective rates of individual income tax under present law 1/ and under various exemption systems, for specified amounts of net income
Married person - Two dependents

Footnotes

Note: Computations were made from unrounded figures and will not necessarily agree with figures computed from the rounded amounts and percentages shown.

1/ Internal Revenue Code, as amended by Revenue Act of 1945.
2/ Also the exemption under levels of $800 for single persons, $1,200 for married couples, and $400 for dependents (Combination B).
3/ Exemption under $600 per capita and under levels of $800 for single persons, $1,600 for married couples, and $400 for dependents (Combination A).
4/ Exemption under levels of $1,000 for single persons, $1,500 for married couples, and $500 for dependents (Combination B).
5/ Exemption under level of $700 per capita.
6/ Exemption under levels of $1,000 for single persons, $2,000 for married couples, and $500 for dependents (Combination A).
7/ Taking into account maximum effective rate limitation of 85.5 percent.

Table 5e

Decrease in amounts and effective rates of individual income tax under various exemption systems compared with present law 1/ and tax decrease as a percentage of present tax liability, for specified amounts of net income

Married person - Two dependents

Net income before personal exemption	Decrease in amounts of tax compared with present law			
	$2,400 exemption 2/	$2,500 exemption 3/	$2,800 exemption 4/	$3,000 exemption 5/
$2,000	-	-	-	-
3,000	$76	$95	$152	$190
4,000	76	95	152	190
5,000	84	105	167	209
6,000	84	105	167	209
8,000	99	124	198	247
10,000	114	143	228	285
15,000	163	204	327	409
25,000	224	280	448	561
50,000	274	342	547	684
100,000	331	413	661	827
500,000	346	432	692	865
1,000,000	346	432	692	865
5,000,000	-	-	-	-

Net income before personal exemption	Decrease in effective rates compared with present law			
	$2,400 exemption 2/	$2,500 exemption 3/	$2,800 exemption 4/	$3,000 exemption 5/
$2,000	-	-	-	-
3,000	2.5%	3.2%	5.1%	6.3%
4,000	1.9	2.4	3.8	4.8
5,000	1.7	2.1	3.3	4.2
6,000	1.4	1.7	2.8	3.5
8,000	1.2	1.5	2.5	3.1
10,000	1.1	1.4	2.3	2.9
15,000	1.1	1.4	2.2	2.7
25,000	.9	1.1	1.8	2.3
50,000	.6	.7	1.1	1.4
100,000	.3	.4	.7	.8
500,000	.1	.1	.1	.2
1,000,000	*	*	.1	.1
5,000,000	-	-	-	-

Continued on next page

Footnotes on next page

Table 5e - concluded

Decrease in amounts and effective rates of individual income tax under various exemption systems compared with present law 1/ and tax decrease as a percentage of present tax liability, for specified amounts of net income

Married person - Two dependents

Net income before personal exemption	Tax decrease as a percentage of present tax liability: $2,400 exemption 2/	$2,500 exemption 3/	$2,800 exemption 4/	$3,000 exemption 5/
$2,000	-	-	-	-
3,000	40.0%	50.0%	80.0%	100.0%
4,000	20.0	25.0	40.0	50.0
5,000	14.2	17.7	28.4	35.5
6,000	10.5	13.1	21.0	26.2
8,000	7.7	9.6	15.3	19.1
10,000	6.1	7.7	12.2	15.3
15,000	4.5	5.6	9.0	11.2
25,000	2.6	3.3	5.3	6.6
50,000	1.1	1.4	2.3	2.8
100,000	.5	.7	1.1	1.3
500,000	.1	.1	.2	.2
1,000,000	*	.1	.1	.1
5,000,000	-	-	-	-

Treasury Department, Division of Tax Research

Note: Computations were made from unrounded figures and will not necessarily agree with figures computed from the rounded amounts and percentages shown.

1/ Internal Revenue Code, as amended by Revenue Act of 1945.
2/ Exemption under $600 per capita and under levels of $800 for single persons, $1,600 for married couples, and $400 for dependents (Combination A).
3/ Exemption under levels of $1,000 for single persons, $1,500 for married couples, and $500 for dependents (Combination B).
4/ Exemption under level of $700 per capita.
5/ Exemption under levels of $1,000 for single persons, $2,000 for married couples, and $500 for dependents (Combination A).

* Less than 0.05 percent.

Table 6

Comparison of amounts and effective rates of individual income tax liabilities 1/ under alternative exemption systems of $600 per capita and Combination B, $800-$1,200-$400, 2/ for specified amounts of net income

Single person - No dependents

Net income before personal exemption	Amounts			Effective rates		
	$600 per capita	Combination B	Difference	$600 per capita	Combination B	Difference
$ 600	-	-	-	-	-	-
800	$ 38	-	$ 38	4.8%	-	4.8%
1,000	76	$ 38	38	7.6	3.8%	3.8
1,500	171	133	38	11.4	8.9	2.5
2,000	266	228	38	13.3	11.4	1.9
3,000	464	422	42	15.5	14.1	1.4
4,000	673	631	42	16.8	15.8	1.0
5,000	897	847	49	17.9	16.9	1.0
6,000	1,144	1,094	49	19.1	18.2	.8
8,000	1,691	1,634	57	21.1	20.4	.7
10,000	2,314	2,250	65	23.1	22.5	.6
15,000	4,226	4,136	89	28.2	27.6	.6
25,000	9,306	9,194	112	37.2	36.8	.4
50,000	25,069	24,932	137	50.1	49.9	.3
100,000	63,458	63,293	165	63.5	63.3	.2
500,000	407,810	407,637	173	81.6	81.5	*
1,000,000	840,060	839,887	173	84.0	84.0	*
5,000,000	4,275,000 3/	4,275,000 3/	-	85.5	85.5	-

Treasury Department, Division of Tax Research

1/ Assuming statutory rates provided under the Revenue Act of 1945.
2/ Single person $800, married couple $1,200, and dependent $400.
3/ Taking into account maximum effective rate limitation of 85.5 percent.

* Less than 0.05 percent

Note: Computations were made from unrounded figures and will not necessarily agree with figures computed from the rounded amounts and percentages shown.

Table 6a

Comparison of amounts and effective rates of individual income tax liabilities 1/ under alternative exemption systems of $600 per capita and Combination B, $800-$1,200-$400, 2/ for specified amounts of net income

Married person - No dependents

Net income before personal exemption	Amounts			Effective rates		
	$600 per capita	Combination B	Difference	$600 per capita	Combination B	Difference
$ 1,200	-	-	-	-	-	-
1,500	$ 57	$ 57	-	3.8%	3.8%	-
2,000	152	152	-	7.6	7.6	-
3,000	342	342	-	11.4	11.4	-
4,000	547	547	-	13.7	13.7	-
5,000	756	756	-	15.1	15.1	-
6,000	996	996	-	16.6	16.6	-
8,000	1,520	1,520	-	19.0	19.0	-
10,000	2,120	2,120	-	21.2	21.2	-
15,000	3,965	3,965	-	26.4	26.4	-
25,000	8,970	8,970	-	35.9	35.9	-
50,000	24,658	24,658	-	49.3	49.3	-
100,000	62,962	62,962	-	63.0	63.0	-
500,000	407,292	407,292	-	81.5	81.5	-
1,000,000	839.542	839,542	-	84.0	84.0	-
5,000,000	4,275,000 3/	4,275,000 3/	-	85.5	85.5	-

Treasury Department, Division of Tax Research

1/ Assuming statutory rates provided under the Revenue Act of 1945.
2/ Single person $800, married couple $1,200, and dependent $400.
3/ Taking into account maximum effective rate limitation of 85.5 percent.

Note: Computations were made from unrounded figures and will not necessarily agree with figures computed from the rounded amounts and percentages shown.

Table 6b

Comparison of amounts and effective rates of individual income tax liabilities 1/ under alternative exemption systems of $600 per capita and Combination B, $800-$1,200-$400, 2/ for specified amounts of net income

Married person - Two dependents

Net income before personal exemption	Amounts			Effective rates		
	$600 per capita	Combination B	Difference	$600 per capita	Combination B	Difference
$ 2,000	-	-	-	-	-	-
3,000	$ 114	$ 190	$ -76	3.8%	6.3%	-2.5%
4,000	304	380	-76	7.6	9.5	-1.9
5,000	505	589	-84	10.1	11.8	-1.7
6,000	714	798	-84	11.9	13.3	-1.4
8,000	1,193	1,292	-99	14.9	16.2	-1.2
10,000	1,748	1,862	-114	17.5	18.6	-1.1
15,000	3,475	3,639	-163	23.2	24.3	-1.1
25,000	8,297	8,522	-224	33.2	34.1	-.9
50,000	23,837	24,111	-274	47.7	48.2	-.5
100,000	61,970	62,301	-331	62.0	62.3	-.3
500,000	406,254	406,600	-346	81.3	81.3	-.1
1,000,000	838,504	838,850	-346	83.9	83.9	*
5,000,000	4,275,000 3/	4,275,000 3/	-	85.5	85.5	-

Treasury Department, Division of Tax Research

1/ Assuming statutory rates provided under the Revenue Act of 1945.
2/ Single person $800, married couple $1,200, and dependent $400.
3/ Taking into account maximum effective rate limitation of 85.5 percent.

* Less than 0.05 percent.

Note: Computations were made from unrounded figures and will not necessarily agree with figures computed from the rounded amounts and percentages shown.

Table 7

Comparison of amounts and effective rates of individual income tax liabilities 1/ under alternative exemption systems of $700 per capita and Combination A, $800-$1,600-$400, 2/ for specified amounts of net income

Single person - No dependents

Net income before personal exemption	Amounts: $700 per capita	Amounts: Combination A	Amounts: Difference	Effective rates: $700 per capita	Effective rates: Combination A	Effective rates: Difference
$ 700	-	-	-	-	-	-
800	$ 19	-	$ 19	2.4%	-	2.4%
1,000	57	$ 38	19	5.7	3.8%	1.9
1,500	152	133	19	10.1	8.9	1.3
2,000	247	228	19	12.4	11.4	1.0
3,000	443	422	21	14.8	14.1	.7
4,000	652	631	21	16.3	15.8	.5
5,000	872	847	25	17.4	16.9	.5
6,000	1,119	1,094	25	18.7	18.2	.4
8,000	1,663	1,634	29	20.8	20.4	.4
10,000	2,282	2,250	32	22.8	22.5	.3
15,000	4,181	4,136	45	27.9	27.6	.3
25,000	9,250	9,194	56	37.0	36.8	.2
50,000	25,000	24,932	68	50.0	49.9	.1
100,000	63,375	63,293	83	63.4	63.3	1.0
500,000	407,724	407,637	86	81.5	81.5	*
1,000,000	839,974	839,887	86	84.0	84.0	-
5,000,000	4,275,000 3/	4,275,000 3/	-	85.5	85.5	-

Treasury Department, Division of Tax Research

1/ Assuming statutory rates provided under the Revenue Act of 1945.
2/ Single person $800, married couple $1,600, and dependent $400.
3/ Taking into account maximum effective rate limitation of 85.5 percent.

* Less than 0.05 percent.

Note: Computations were made from unrounded figures and will not necessarily agree with figures computed from the rounded amounts and percentages shown.

Table 7a

Comparison of amounts and effective rates of individual income tax liabilities 1/ under alternative exemption systems of $700 per capita and Combination A, $800-$1,600-$400, 2/ for specified amounts of net income

Married person - No dependents

Net income before personal exemption	Amounts: $700 per capita	Amounts: Combination A	Amounts: Difference	Effective rates: $700 per capita	Effective rates: Combination A	Effective rates: Difference
$ 1,400	-	-	-	-	-	-
1,500	$ 19	-	$ 19	1.3%	-	1.3%
2,000	114	$ 76	38	5.7	3.8%	1.9
3,000	304	266	38	10.1	8.9	1.3
4,000	505	464	42	12.6	11.6	1.0
5,000	714	673	42	14.3	13.5	.8
6,000	946	897	49	15.8	14.9	.8
8,000	1,463	1,406	57	18.3	17.6	.7
10,000	2,056	1,991	65	20.6	19.9	.6
15,000	3,884	3,802	82	25.9	25.3	.5
25,000	8,858	8,746	112	35.4	35.0	.4
50,000	24,521	24,385	137	49.0	48.8	.3
100,000	62,797	62,632	165	62.8	62.6	.2
500,000	407,119	406,946	173	81.4	81.4	*
1,000,000	839,369	839,196	173	83.9	83.9	*
5,000,000	4,275,000 3/	4,275,000 3/	-	85.5	85.5	-

Treasury Department, Division of Tax Research

1/ Assuming statutory rates provided under the Revenue Act of 1945.
2/ Single person $800, married couple $1,600, and dependent $400.
3/ Taking into account maximum effective rate limitation of 85.5 percent.

* Less than 0.05 percent.

Note: Computations were made from unrounded figures and will not necessarily agree with figures computed from the rounded amounts and percentages shown.

Table 7b

Comparison of amounts and effective rates of individual income tax liabilities 1/ under alternative exemption systems of $700 per capita and Combination A, $800-$1,600-$400, 2/ for specified amounts of net income

Married person - Two dependents

Net income before personal exemption	Amounts: $700 per capita	Amounts: Combination A	Amounts: Difference	Effective rates: $700 per capita	Effective rates: Combination A	Effective rates: Difference
$ 2,000	-	-	-	-	-	-
3,000	$ 38	$ 114	$ - 76	1.3%	3.8%	- 2.5%
4,000	228	304	- 76	5.7	7.6	- 1.9
5,000	422	505	- 84	8.4	10.1	- 1.7
6,000	631	714	- 84	10.5	11.9	- 1.4
8,000	1,094	1,193	- 99	13.7	14.9	- 1.2
10,000	1,634	1,748	- 114	16.3	17.5	- 1.1
15,000	3,312	3,475	- 163	22.1	23.2	- 1.1
25,000	8,073	8,297	- 224	32.3	33.2	- .9
50,000	23,564	23,837	- 274	47.1	47.7	- .5
100,000	61,640	61,970	- 331	61.6	62.0	- .3
500,000	405,908	406,254	- 346	81.2	81.3	- .1
1,000,000	838,158	838,504	- 346	83.8	83.9	*
5,000,000	4,275,000 3/	4,275,000 3/	-	85.5	85.5	-

Treasury Department, Division of Tax Research

1/ Assuming statutory rates provided under the Revenue Act of 1945.
2/ Single person $800, married couple $1,600, and dependent $400.
3/ Taking into account maximum effective rate limitation of 85.5 percent.

* Less than 0.05 percent.

Note: Computations were made from unrounded figures and will not necessarily agree with figures computed from the rounded amounts and percentages shown.

Table 8

Comparison of amounts and effective rates of individual income tax liabilities under present law 1/ and under tax credit proposal 2/

Single person - No dependents

Net income before personal exemption	Amounts of tax: Present law 1/	Amounts of tax: Tax credit 2/ proposal	Amounts of tax: Increase over present law	Effective rates: Present law 1/	Effective rates: Tax credit 2/ proposal	Effective rates: Increase over present law
$ 500	-	-	-	-	-	-
1,000	$ 95	$ 95	-	9.5%	9.5%	-
1,500	190	190	-	12.7	12.7	-
2,000	285	285	-	14.3	14.3	-
2,500	380	390	$ 10	15.2	15.6	.4%
3,000	485	494	10	16.2	16.5	.3
3,500	589	599	10	16.8	17.1	.3
4,000	694	703	10	17.3	17.6	.2
4,500	798	827	29	17.7	18.4	.6
5,000	922	950	29	18.4	19.0	.6
6,000	1,169	1,197	29	19.5	20.0	.5
8,000	1,720	1,767	48	21.5	22.1	.6
10,000	2,347	2,413	67	23.5	24.1	.7
15,000	4,270	4,399	128	28.5	29.3	.9
20,000	6,645	6,802	157	33.2	34.0	.8
25,000	9,362	9,548	185	37.5	38.2	.7
50,000	25,137	25,384	247	50.3	50.8	.5
100,000	63,541	63,859	318	63.5	63.9	.3
500,000	407,897	408,234	337	81.6	81.6	.1
1,000,000	840,147	840,484	337	84.0	84.0	*
5,000,000	4,275,000 3/	4,275,000 3/	-	85.5	85.5	-

Treasury Department, Division of Tax Research

1/ Internal Revenue Code, as amended by Revenue Act of 1945.
2/ Tax credit of $55 per capita in lieu of present exemptions.
3/ Assuming maximum effective rate limitation of 85.5 percent applies after allowance of tax credit.
* Less than .05 percent.

Note: Computations were made from unrounded figures and will not necessarily agree with figures computed from the rounded amounts and percentages shown.

Table 8a

Comparison of amounts and effective rates of individual income tax liabilities under present law 1/ and under tax credit proposal 2/

Married person - No dependents

Net income before personal exemption	Amounts of tax: Present law 1/	Tax credit 2/ proposal	Increase over present law	Effective rates: Present law 1/	Tax credit 2/ proposal	Increase over present law
$ 1,000	-	-	-	-	-	-
1,500	$ 95	$ 95	-	6.3%	6.3%	-
2,000	190	190	-	9.5	9.5	-
2,500	285	295	$ 10	11.4	11.8	.4%
3,000	380	399	19	12.7	13.3	.6
3,500	485	504	19	13.8	14.4	.5
4,000	589	608	19	14.7	15.2	.5
4,500	694	732	38	15.4	16.3	.8
5,000	798	855	57	16.0	17.1	1.1
6,000	1,045	1,102	57	17.4	18.4	1.0
8,000	1,577	1,672	95	19.7	20.9	1.2
10,000	2,185	2,318	133	21.9	23.2	1.3
15,000	4,047	4,304	257	27.0	28.7	1.7
20,000	6,394	6,707	314	32.0	33.5	1.6
25,000	9,082	9,453	371	36.3	37.8	1.5
50,000	24,795	25,289	494	49.6	50.6	1.0
100,000	63,128	63,764	637	63.1	63.8	.6
500,000	407,465	408,139	675	81.5	81.6	.1
1,000,000	839,715	840,389	675	84.0	84.0	.1
5,000,000	4,275,000 3/	4,275,000 3/	-	85.5	85.5	-

Treasury Department, Division of Tax Research

1/ Internal Revenue Code, as amended by Revenue Act of 1945.
2/ Tax credit of $95 per capita in lieu of present exemptions.
3/ Assuming maximum effective rate limitation of 85.5 percent applies after allowance of tax credit.

Note: Computations were made from unrounded figures and will not necessarily agree with figures computed from the rounded amounts and percentages shown.

Table 8b

Comparison of amounts and effective rates of individual income tax liabilities under present law 1/ and under tax credit proposal 2/

Married person - Two dependents

Net income before personal exemption	Amounts of tax			Effective rates		
	Present law 1/	Tax credit 2/ proposal	Increase over present law	Present law 1/	Tax credit 2/ proposal	Increase over present law
$ 2,000	-	-	-	-	-	-
2,500	$ 95	$ 105	$ 10	3.8%	4.2%	.4%
3,000	190	209	19	6.3	7.0	.6
3,500	285	314	29	8.1	9.0	.8
4,000	380	418	38	9.5	10.5	1.0
4,500	485	542	57	10.8	12.0	1.3
5,000	589	665	76	11.8	13.3	1.5
6,000	798	912	114	13.3	15.2	1.9
8,000	1,292	1,482	190	16.2	18.5	2.4
10,000	1,862	2,128	266	18.6	21.3	2.7
15,000	3,639	4,114	475	24.3	27.4	3.2
20,000	5,890	6,517	627	29.5	32.6	3.1
25,000	8,522	9,263	741	34.1	37.1	3.0
50,000	24,111	25,099	988	48.2	50.2	2.0
100,000	62,301	63,574	1,273	62.3	63.6	1.3
500,000	406,600	407,949	1,349	81.3	81.6	.3
1,000,000	838,850	840,199	1,349	83.9	84.0	.1
5,000,000	4,275,000 3/	4,275,000 3/	-	85.5	85.5	-

Treasury Department, Division of Tax Research

1/ Internal Revenue Code, as amended by Revenue Act of 1945.
2/ Tax credit of $95 per capita in lieu of present exemptions.
3/ Assuming maximum effective rate limitation of 85.5 percent applies after allowance of tax credit.

Note: Computations were made from unrounded figures and will not necessarily agree with figures computed from the rounded amounts and percentages shown.

TREASURY DEPARTMENT
Washington

FOR IMMEDIATE RELEASE,
Tuesday, December 30, 1947.

Press Service
No. S-581

The Secretary of the Treasury today announced the subscription and allotment figures with respect to the current offering of 1-1/8 percent Treasury Certificates of Indebtedness of Series A-1949, to be dated January 1, 1948.

Subscriptions and allotments were divided among the several Federal Reserve Districts and the Treasury as follows:

Federal Reserve District	Total Subscriptions Received & Allotted
Boston	$ 62,752,000
New York	1,302,652,000
Philadelphia	49,374,000
Cleveland	74,237,000
Richmond	43,760,000
Atlanta	74,084,000
Chicago	366,774,000
St. Louis	108,398,000
Minneapolis	53,258,000
Kansas City	137,212,000
Dallas	68,742,000
San Francisco	248,865,000
Treasury	610,000
TOTAL	$2,590,718,000

By arrangements made between the Treasury and the Federal Reserve System, the System's holdings of maturing certificates amounting to $400,000,000 will be presented for cash redemption on January 1.

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