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THE FEDERAL REVENUE SYSTEM: FACTS AND PROBLEMS

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LETTERS OF TRANSMITTAL

NOVEMBER 1, 1955.

Hon. PAUL H. DOUGLAS,
Chairman, Joint Committee on the Economic Report,
United States Senate, Washington, D. C.

DEAR SENATOR DOUGLAS: Transmitted herewith is a staff report containing information and statistics relating to a number of the major elements of the present Federal revenue system. The report was prepared at the request of the Subcommittee on Tax Policy which, pursuant to instructions contained in the March 14, 1955, report of the full committee, is conducting a study of Federal tax policy for economic growth and stability.

The subcommittee appreciates the cooperation afforded its staff by the staffs of Federal executive departments and committees of the Congress, and the Legislative Reference Service. The materials in this report do not necessarily represent the views of the subcommittee or of its individual members.

WILBUR D. MILLS,
Chairman, Subcommittee on Tax Policy.

NOVEMBER 1, 1955.

Hon. WILBUR D. MILLS,
Chairman, Subcommittee on Tax Policy,
House of Representatives, Washington, D. C.

DEAR MR. MILLS: Transmitted herewith is a staff report prepared at the request of the Subcommittee on Tax Policy for its use in the December 1955 hearings on Federal tax policy for economic growth and stability.

This report consists of information and statistics about each of the major elements of the Federal revenue system which the subcommittee will examine in its current study. Each section of the report presents a brief statement of the present statutory provisions, supplemented in some cases by a short account of the legislative history of the principal provisions and in some cases by a comparison with the corresponding provisions in other countries. In addition, each section contains a statement of major issues which have arisen in these areas of the tax law and of the principal arguments which have been advanced with respect to these issues. A final section of the report presents the most recent statistics available bearing on the operation of the Federal revenue system.

In preparing this report, every effort has been made to maintain complete objectivity. Accordingly, no attempt has been made to evaluate the various arguments offered on any side of the issues presented. The purpose, rather, has been to provide as accurate a statement as possible of these issues and arguments, leaving appraisal of their validity to the reader.

The report was prepared by Norman B. Ture, staff economist for the Subcommittee on Tax Policy. Grateful acknowledgment is made of the very capable and extensive assistance afforded by Dr. Raymond Manning and Mr. Hamilton Gewehr, of the Legislative Reference Service, Library of Congress. Dr. Manning provided much of the factual material in the report, while Mr. Gewehr worked on the statistical materials. The staff is also grateful for the assistance of the technicians on congressional and executive agency staffs who checked the report for accuracy and who assisted in providing statistical materials. In addition, considerable use was made of studies prepared and released by the Treasury Department and by the Joint Committee on Internal Revenue Taxation. The materials in this report do not necessarily reflect the views of those assisting the subcommittee staff.

In the preparation of these materials, the staff has not had the benefit of the papers prepared by the panelists invited to appear before the subcommittee during its hearings on December 5–16. These papers are to be compiled in a compendium, "Federal Tax Policy for Economic Growth and Stability," for publication in mid-November.

Grover W. Ensley,
Executive Director, Joint Committee on the Economic Report.

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I. Present Law

Under present law, the statutory definition of income for tax purposes differs markedly from that employed in national income accounting. These differences reflect not only basic divergences between the legal and economic concepts of income but also the results of a prolonged legislative process of providing special tax treatment for specific items of income and expense. In some cases, the occasion for the special treatment has been the encouragement of certain types of socially desirable activity; in others, the special treatment was intended to provide highly selective tax relief. A major effect of this process has been to increase the disparity between the economic concept of personal income and the income to which the statutory tax rates are applied.

In the statutory sense, there are three principal categories of adjustments made in determining the amount of a taxpayer's income on which tax liability accrues. These are the adjustments which (1) exclude certain types of personal receipts from the taxpayer's gross income, (2) provide deductions from gross income for trade and business expenses in determining adjusted gross income, and (3) provide for the deduction from adjusted gross incomes of certain nontrade or nonbusiness expense items (including the deduction for personal exemptions) in arriving at taxable income. In addition, adjustments are made in tax liabilities by means of tax credits with respect to certain types of income.

A. EXCLUSIONS FROM GROSS INCOME

The Internal Revenue Code of 1954 defines "gross income" as "* * * all income from whatever source derived * * *."[1] Notwithstanding this all-inclusive statutory concept, specific exceptions have been made, in the statute, by court decision, and by administrative ruling, to exclude a wide range of personal receipts. The major income items explicitly excluded from gross income are:

(*a*) Annuities, pensions, death benefits, compensation for injury, etc.:
Social Security Act benefits and similar Government transfer payments, including unemployment compensation[2] and relief payments.

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[1] Sec. 61 (a).
[2] I. T. 3230, 1938-2 C. B. 136, I. T. 3194, 1938-1 C. B. 114, I. T. 3447, 1941-1 C. B. 191, I. T. 3229, 1938-2 C. B. 136.

Railroad Retirement Act payments. [3]
Veterans' pensions (exclusive of retirement pay based on age or length of service). [4]
Pensions and other payments arising out of injury or sickness, including payments received through accident or health insurance. [5]
Payments in lieu of wages during injury or sickness (up to $100 per week). [6]
Life insurance and other payments made by reason of death (but not exceeding $5,000 in case of payment to beneficiary of deceased employee). [7]
Employer contributions to employee pension, accident or health plans. [8]

(*b*) Other employee benefits:
Meals or lodging furnished on premises by and for convenience of employer. [9]
State and local police subsistence allowances up to $5 per day. [10]
Rental value of dwelling or rental allowance of clergymen. [11]
Subsistence and rental allowances of members of Armed Forces. [12]
Combat and mustering out pay of members of Armed Forces. [13]

(*c*) Other:
Gifts and inheritances. [14]
Scholarship and fellowship grants (subject to limitations). [15]
Interest on State and local government obligations. [16]
Interest on certain Federal Government obligations issued prior to March 1, 1941. [17]
Allocation certificates having no fair market value issued by cooperatives to patron members. [18]
Income earned abroad under certain conditions. [19]
Income earned within United States possessions under certain conditions. [20]
Income from discharge of indebtedness incurred in connection with property used in trade or business. [21]
Recovery of previously deducted bad debts, prior taxes, etc., when deduction did not result in tax benefit. [22]
Improvements by lessee on lessor's property (unless made in lieu of rent). [23]

[3] I. T. 3662, 1944–C. B. 72.
[4] Sec. 3, Public Law 262, 74th Cong., 38 U. S. C. 454A.
[5] Sec. 104.
[6] Sec. 105.
[7] Sec. 101.
[8] Sec. 106.
[9] Sec. 119.
[10] Sec. 120.
[11] Sec. 107.
[12] *Clifford Jones* v. *U. S.*, 60 Court of Claims 552 (1 U. S. T. C., § 129), I. T. 2760, XIII–1 C. B. 35, I. T. 3420, 1940–2 C. B. 40, Minn. 3413, V–1, C. B. 29, Modified by Rev. Rule 55–572, 37 I. R. B. (1955), p. 9.
[13] Secs. 112, 113.
[14] Sec. 102.
[15] Sec. 117.
[16] Sec. 103.
[17] Sec. 103.
[18] Phillips, 17 T. C. 1027, Hoey, 13 T. C. M., Carpenter, 20 T. C. 603, affirmed 219 Fed. 2d 635, But see Rev. Rules 54–10 and 55–66.
[19] Sec. 911.
[20] Sec. 931.
[21] Sec. 108.
[22] Sec. 111.
[23] Sec. 109.

Dividends received from domestic corporations, up to $50 per year.[24]

In addition, certain types of income, particularly certain types of income in kind, while not explicitly excluded from gross income, have never been construed in practice as included in this concept. Chief among these are the rental value of owner-occupied residences and certain types of goods and services produced for consumption by the taxpayer and his family; e. g., farm produce and merchandise inventory items. While the language of the statute is broad enough to construe the latter category in gross income, such a construction is not generally made.

Many of the items excluded from the statutory concept of gross income represent sizable amounts of personal income. For example, imputed net rental income from owner-occupied houses in 1954 is estimated by the Department of Commerce as $5.8 billion, while food and fuel produced and consumed on farms is valued at $1.9 billion.[25] Federal Government transfer payments, including benefits from social insurance funds, military pensions, and veterans benefits amounted to $11.7 billion.[26]

B. DEDUCTIONS

Deductions from gross income which individuals may claim in determining taxable income fall into two broad categories. The first of these consists of "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *"[27] and in the case of employees, expenses incurred on behalf of the employer (1) as an outside salesman, (2) for travel while away from home, (3) for transportation, and (4) expenses for which reimbursement is made.[28] The principal example of ordinary and necessary expenses in carrying on a trade or business are salaries, wages, and other payments made as compensation for personal services, depreciation and depletion, taxes, interests, and losses. Deductions for business expenses, plus those allowed (1) for expenses for production of income, (2) for losses realized on the sale or exchange of property, and (3) for 50 percent of the excess of net long-term capital gains over net short-term capital losses, are offset against gross income in arriving at adjusted gross income.[29]

The second category of deductions includes a large number of nonbusiness expenses. These are:

(1) Medical expenses incurred on behalf of the taxpayer, his wife, and dependents, to the extent the expenses exceed 3 percent of his adjusted gross income. The 3 percent limitation does not apply if the taxpayer or his spouse is 65 or over. The deduction may not exceed $5,000 on the return of a single individual or married person filing separately, or $10,000 on a joint return or return by a head-of-household.[30]

(2) Contributions to certain types of nonprofit organizations, including religious, educational, scientific, and charitable organizations.

[24] Sec. 116.
[25] Department of Commerce, Survey of Current Business, July 1955, p. 21.
[26] Ibid.
[27] Sec. 162 (a).
[28] Sec. 62.
[29] Sec. 62.
[30] Sec. 213.

The deductions may not exceed 30 percent of the taxpayer's adjusted gross income.[31]

(3) Taxes paid, other than Federal income taxes, import duties, excises and stamp taxes, death and gift taxes, and local improvement taxes.[32]

(4) Interest on indebtedness, with certain exceptions relating to amounts paid in connection with insurance, endowment, or annuity contracts, tax-exempt income, carrying charges chargeable to capital accounts, and transactions between related taxpayers.[33]

(5) Alimony and separate maintenance payments to the extent these amounts are includible in the gross income of the recipient.[34]

(6) Losses from fire, theft, and other casualty, to the extent these are not compensated by insurance.[35]

(7) Certain expenses associated with the taxpayer's occupation, such as union dues, professional association membership fees and journal subscriptions, uniforms, and other types of special work apparel.[36]

(8) Expenses incurred by a woman or widower for the care of dependents to enable the taxpayer to be gainfully employed. The deduction is limited to $600 per year and is reduced in the case of a working wife by the amount by which the combined adjusted gross income of husband and wife exceeds $4,500. The dependent with respect to whom the expenses are incurred must be the taxpayer's child or stepchild, who is either under 12 years of age or is physically or mentally unable to care for himself.[37]

These expenses may be itemized by the taxpayer and deducted from adjusted gross income. In lieu of itemizing the deductions, the taxpayer may claim a standard deduction equal to 10 percent of the adjusted gross income reported on the return but not more than $1,000 or in the case of a separate return by a married person, not more than $500.[38]

C. PERSONAL EXEMPTIONS

The most important deduction provided for individual taxpayers is that for personal exemptions. Under the Internal Revenue Code of 1954,[39] the taxpayer is permitted to deduct an exemption of $600 for himself and an additional exemption of $600 for his spouse and for each dependent. To qualify for the exemption, the dependent must (1) be related to the taxpayer in a manner specified in the statute or be a member of the taxpayer's household, (2) receive less than $600 gross income, except in the case of the taxpayer's child who is under 19 or if over 19, who is a student, and (3) receive over half his support from the taxpayer, except where a multiple-support agreement is effected.

An additional $600 exemption is provided for a taxpayer aged 65 or over and also for his spouse if 65 years of age or more. An additional $600 exemption is also provided for a blind taxpayer or for a blind spouse. Accordingly, if both the taxpayer and his spouse were both blind and 65 or over, total exemptions, without reference to dependents, would be $3,600.

[31] Sec. 170.
[32] Sec. 164.
[33] Sec. 163.
[34] Sec. 215.
[35] Sec. 165.
[36] Sec. 212.
[37] Sec. 214.
[38] Sec. 141.
[39] Secs. 151–153.

The present per capita exemption system was first provided for the taxable year 1944. Prior to that time, differential amounts were allowed as exemptions for single and married persons and for dependents. The following table summarizes in broad outline the history of personal exemptions in the Federal income tax.

Year	Single	Married	Dependents
1913–16	$3,000	$4,000	0
1917–20	1,000	2,000	$200
1921–24	1,000	2,500	400
1925–31	1,500	3,500	400
1932–39	1,000	2,500	400
1940	800	2,000	400
1941	750	1,500	400
1942–43	500	1,200	350
1944–47	500	1,000	500
1948–	600	1,200	600

D. INCOME SPLITTING

In addition to exclusions and deductions from income, the structure of the individual income tax is significantly affected by the provisions for income splitting. The income-splitting provision permits married persons filing a joint return to compute tax liability by applying the statutory rates to one-half the combined taxable income shown on the return and multiplying the resulting tax by two.[40] Because of the graduation of the tax rates, income splitting on a joint return results in a lower tax liability than that on separate returns whenever the taxable income of either the husband or wife exceeds $2,000. Single individuals who meet the statutory qualifications for a "head-of-household" are permitted to use a separate rate schedule which accords approximately one-half of the tax benefits of income splitting.

Provision for income splitting was made in the Revenue Act of 1948 as a means of equalizing the tax treatment of married couples in community property and noncommunity property States. Under the community property doctrine, the income of a married couple is regarded as equally divided between the two. Court interpretations of the tax law permitted the filing of separate income-tax returns, each reporting one-half of the community income. Prior to 1948 a married couple in a noncommunity property State could report on separate returns only the actual income received by each spouse, and where all or most of the combined income was received by one spouse, even the filing of separate returns frequently resulted in one spouse falling into a higher rate bracket and a greater combined tax liability than in the community-property State. Permitting all married couples to file joint returns and to split the taxable income for purposes of the tax computation, therefore, was proposed as a means of providing the same liability as if separate returns showing one-half the combined income were filed, as in community-property States.

E. TAX CREDITS

Individual income-tax liability may also be affected by a number of specific tax credits. One of these is the credit for partially tax-exempt interest received on certain Federal Government bonds.[41]

[40] Sec. 2.
[41] Sec. 35.

This credit is limited to 3 percent of the partially exempt interest but may not exceed the lesser of 3 percent of taxable income or tax liability before the credit. A credit is also allowed for certain foreign taxes paid subject to certain limitations.[42]

Two additional tax credits were provided in the Internal Revenue Code of 1954. The first of these permits the taxpayer to reduce his tax liability by an amount equal to 4 percent of the dividends he receives from domestic corporations in excess of the amount of such dividends excluded from gross income. This credit may not exceed the lesser of 4 percent of taxable income or the amount of tax liability before the credit but reduced by the amount of the foreign tax credit.[43]

The second new credit is available to retired individuals over 65 (or under 65 if retired under a public retirement system) and is equal to 20 percent of qualified amounts of retirement income up to $1,200. Retirement income is defined as pensions and annuities from a public retirement system, in the case of an individual under 65, and as pensions, annuities, interest, rents, and dividends in all other cases. The amount of retirement income on which the tax credit is based may not exceed $1,200 less (1) the amount received as a pension or annuity under the Social Security and Railroad Retirement Acts or otherwise excluded from gross income, and (2) in the case of a taxpayer under 75, any amount of earned income in excess of $900. In addition, the amount of the credit may not exceed the tax before the credit but reduced by any other credits allowable.[44]

F. MAGNITUDE OF STATUTORY ADJUSTMENTS IN DETERMINING TAXABLE INCOME

Comparison of national income accounts with tax data reveals that a relatively small proportion of total individual income is subject to the Federal income tax. In 1953, for example, personal income [45] amounted to $286.2 billion; taxable income (the amount of income to which the statutory tax rates are actually applied) in that year is estimated at about $118 billion or roughly 40 percent of personal income.

The relationship of taxable income to personal income has risen gradually over the last 15 years, from about 14 percent in 1940 to the present level of about 40 percent. In part, this rise is due to the specific legislative provisions in the early 1940's which significantly broadened the tax base by reducing personal exemptions. Since that time, however, a major factor has been the continuing rise in income which tends to increase the amount of total income in excess of aggregate exemptions. Rising wage rates have been significant in this respect.[46]

The relative importance of the various adjustments accounting for the differences between personal and taxable income may be illustrated by reference to data for the year 1950. Personal income for that year

[42] Secs. 33, 901. See Taxation of Income Derived Abroad.
[43] Sec. 34.
[44] Sec. 37.
[45] Personal income is defined by the Department of Commerce as the current income received by persons from all sources, including transfers from government and business but excluding transfers among persons. It is measured as the sum of wage and salary disbursements, other labor income, proprietor's and rental income, interest and dividends and transfer payments, minus personal contributions for social insurance. Cf. U. S. Department of Commerce, Office of Business Economics, National Income Supplement to the Survey of Current Business, 1954, p. 58.
[46] For example, as a result of the rise in wage rates, total wages paid to a student for summer employment are more likely than formerly to exceed the $600 individual income tax filing requirement.

was $227.1 billion. Explicit and implicit statutory exclusions from gross income amounted to about $33.7 billion, while income items not included in personal income but included in statutory gross income [47] amounted to $7.5 billion. Accordingly, net exclusions amounted to $26.2, or 11.5 percent of personal income. The difference between these amounts, roughly $200 billion, may be regarded as the total adjusted gross income received by individuals in 1950. Not all of this amount, however, is shown on individual tax returns for that year, since, in the case of some individuals, the adjusted gross income received was less than the minimum income required for the filing of a tax return.

Total adjusted gross income reported on tax returns in 1950 amounted to about $179.1 billion. Of this amount, about $20.6 billion was reported by nontaxable individuals filing returns, leaving about $158.5 billion as the adjusted gross income of taxable individuals. Total deductions on taxable returns amounted to about $19.0 billion, of which $8.9 billion were itemized, the remaining $10.1 billion having been claimed under the standard deduction. Deductions for personal exemptions on taxable returns totaled $55.2 billion, leaving taxable income of $84.3 billion.[48] Accordingly, the income tax base in 1950 represented about 37 percent of personal income.

II. Issues and Proposals

The structural features of the individual income tax have been one of the major sources of controversy since the inception of the tax. At the present time, this controversy centers on basic questions as to the impact of the steeply graduated marginal rate structure on work and investment incentives and the effect of the overall income tax structure on income distribution, on effective progression, and on the sensitivity of the tax to changes in personal income. A corollary issue concerns the effects of various structural features, which produce nonuniformity of treatment, on the fairness of the tax as viewed by the taxpaying population as a whole.

A. IMPACT OF RATE STRUCTURE ON PERSONAL INCENTIVES

Statutory tax rates under the present law range from 20 percent on taxable incomes under $2,000 ($4,000 in the case of joint returns) to 91 percent on taxable incomes in excess of $200,000 ($400,000 in the case of a joint return). There is general agreement that this rate structure is a steeply progressive one, both in terms of the range of rates—71 percentage points from the bottom to the top of the rate structure—and the relatively limited range of income—$2,000 to $200,000—over which these rates are spread.

Considerable opposition has developed to the sharp graduation of rates in the income tax. This is reflected in a number of proposals which have been advanced in recent years for a constitutional amendment which would limit the spread between the bottom and top marginal tax rates to, say, 15 percentage points.[49]

[47] Chief among such items are employee contributions for social insurance and net gains from the sale of property by individuals. These amounted to $5.7 billion in 1950.

[48] Not including about $0.5 billion net income of taxable fiduciaries, but including about $0.6 billion of long-term capital gains not subject to ordinary normal and surtax.

[49] For a discussion of the proposals, see Constitutional Limitation on Federal Income, Estate, and Gift Tax Rates, joint committee print, 82d Cong., 2d sess.

One of the principal arguments upon which such proposals are based is that steep income tax progression has significantly adverse effects on personal incentives for extra effort in providing labor or managerial services, and for assumption of business and investment risks. In the former case, it is argued that such additional efforts necessarily involve costs in terms of leisure and recreational activities which must be given up, and the greater the proportion of the additional money income which must go to pay taxes, the greater the likelihood that the money income left after taxes will be inadequate to warrant the costs. In the latter case, the argument is made that the steep graduation of rates acts as a highly restrictive rationing device which eliminates high-risk ventures since the greater the degree of graduation, the greater the possibility that the after-tax yield which might be realized will be less than the tax value of the possible losses. Moreover, such steep progression might well be expected to limit severely in absolute terms the amount of savings available to implement personal investment.

Those who favor a highly progressive income tax point out that the record of the economy's performance over the past decade does not confirm these consequences. They contend that the rate of capital formation during this period evidences no lack of investable funds, that the rate of formation of new businesses has not fallen, nor has there been any significant trend toward a decrease in labor force participation and hours of work which may not be accounted for by long-term institutional tendencies. They also refer to recent studies which show that the supposed deleterious effects of a steeply progressive income tax are not significantly in evidence.[50]

It is also argued that the statutory rate structure suggests a great deal more rate progression in the income tax than in fact exists. It is pointed out that, contrary to a widespread impression, progression in the rate structure applies only to a very limited amount of income. In the first place, the present system of exclusions and deductions serves to remove about 60 percent of total personal income from the tax base. Secondly, of the remaining 40 percent of income actually subject to tax, only a very small portion is subject to the progressive element in the rate structure. Individual income-tax liabilities in 1951 amounted to $24.2 billion, or 24.6 percent of total taxable income. Since the statutory first bracket rate in that year was 20.4 percent, the overall 24.6 percent effective rate indicates that only 18.2 percent of taxable income was subject to tax at rates above that applicable to the first bracket of taxable income. Moreover, when measured against adjusted gross income, the overall effective rate of tax was only 13.1 percent.

It is also pointed out that even at very high income levels, where presumably the steep graduation in the statutory rate structure has a maximum impact, effective tax rates run considerably below the statutory rates. For individuals with adjusted gross incomes in excess of $1 million, for example, the overall effective rate of tax in 1951 was 62 percent.

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[50] Cf. Butters, Thompson, and Bollinger, Effects of Taxation: Investment by Individuals, and Sanders, Effects of Taxation on Executives.

B. SENSITIVITY OF THE INDIVIDUAL INCOME TAX TO CHANGES IN PERSONAL INCOME

In recent years, there has been increasing recognition of the importance of the individual income tax in fiscal policy aimed at economic stabilization. The expansion of the tax base and the adoption of the current payment system in the early 1940's served to highlight the contribution which a broad-based, pay-as-you-go individual income tax might make in leveling out short-term fluctuations in economic activity. Inflationary expansion of personal income tends to be damped down by the resulting automatic increases in income-tax liabilities. When personal income is falling, on the other hand, automatic reductions in income tax liabilities result in a smaller decline in disposable income, serving to bolster consumption.

The extent of this "built-in flexibility" of the income tax depends on (1) the size and character of the tax base, and (2) the graduation in the tax-rate structure.[51]

Given the size and character of the tax base as determined by the exclusion, deduction, and exemption, provisions of the tax law, it is evident that the steeper the graduation of tax rates, the greater will be the responsiveness of tax changes to income changes. Relatively narrow tax brackets result in a relatively large shift in taxable income among tax rate brackets in response to a change in individuals' total income. Moreover, the greater the difference between the rates applicable to each bracket, the greater will be the change in tax liability as taxable income shifts from one bracket to another.

As a corollary, given the tax-rate structure, it is obvious that the wider the range of income entering into tax computations, the greater will be the responsiveness of tax changes to income changes. If, on the other hand, structural provisions of the tax law serve to remove large amounts of income from tax, significant income changes may occur without tax consequences. According to a recent estimate, for example, at the current level a $10 billion change in total adjusted gross income would result in a $6.5 billion change in income subject to tax, and changes in individual income tax liabilities would amount to about 15–16 percent of the change in adjusted gross income.[52]

Those who favor relying primarily on the individual income tax as a countercyclical fiscal device contend that tax policy should be directed toward increasing the sensitivity of the tax to income changes. They point out that on the basis of the present statutory rate structure, one might expect a substantially higher ratio of tax changes to income changes than is in fact observable. In view of the apparent steepness of graduation in these rates, it is evident that any effort to increase the built-in flexibility of the income tax must involve broadening the tax base relative to personal income, although elimination of income-splitting would serve to restore much of the effective rate graduation that was lost by adoption of this provision. Sufficiently vigorous measures in broadening the tax base, it is argued, would even permit a substantial reduction in statutory tax rates, while at

[51] The promptness with which this built-in flexibility takes effect depends on the time lag between income and tax payments. Under the present current payment system, this lag is relatively insignificant for most individuals.

[52] See Joseph A. Pechman, Yield of the Individual Income Tax During a Recession, National Tax Journal, vol. VII, March 1954, pp. 1–16.

the same time increasing responsiveness of tax liabilities to changes in levels of economic activity.

On the other hand, it is pointed out that the major portion of the difference between income in the national income accounting sense and income subject to tax is accounted for by the present system of personal exemptions. Such exemptions, on both taxable and nontaxable returns, aggregated $83.2 billion in 1950 or 36.6 percent of personal income in that year. Efforts to broaden the tax base, therefore, should properly begin with this major item. Reducing the amount of the per capita exemption, however, would significantly increase the tax burden on low-income families and would, therefore, be regarded by most people as an excessive price to pay for the increased sensitivity of the income tax.

Broadening the tax base by cutting back exclusions, it is argued, would have only a minor effect on the responsiveness of the individual income tax to changes in income. It is pointed out that the major category of excluded income payments consists of social-insurance benefits, e. g., social security, railroad retirement, and unemployment benefits as well as assistance payments to the aged and needy. Including such receipts in income reported for the purposes would not improve the sensitivity of the income tax, since retirement benefits do not depend to a significant extent on levels of economic activity, while taxing relief payments would actually introduce a perverse relationship between tax liabilities and changes in personal income.

The same objection is raised to broadening the tax base by curtailing deductions. Most itemized deductions appear to be largely independent of levels of economic activity. Those deductions, on the other hand, which tend to vary in the same direction as broad economic indicators, account for relatively modest amounts of income. Accordingly, it is argued, whatever the other merits of broadening the tax base, no substantial justification can be found in terms of improving built-in flexibility of the income tax.

C. EQUITY CONSIDERATIONS

There is widespread agreement that the basic principle underlying individual income taxation is that individual tax liabilities should reflect the taxpayer's ability to pay. There are, of course, significant differences in viewpoint as to the appropriate way in which to measure ability to pay and the extent to which such differences, however measured, should be reflected in tax liabilities. On the other hand, little, if any, exception is taken to the proposition that the income tax should apply uniformly to all taxpayers with equal taxpaying ability.

Many of the basic structural provisions of the individual income tax are criticized as producing nonuniformity in tax treatment. A frequently cited illustration is the exclusion of certain types of so-called imputed income from income reported for tax purposes. The imputed rental value of owner-occupied residences may be taken as a case in point. The fact that such income is excluded from gross income results in a lower tax liability for the homeowning taxpayer than for one who rents his residence but receives the same amount of explicit income from other sources. Moreover, the deductibility of property taxes and interest payments further enhances the relative tax position of the homeowner. Similarly, the fact that the net value of food and fuel produced and consumed by farm families is not included in the tax base results in preferential tax treatment for the farmer as compared with an industrial worker with the same cash income.

It is contended that differential tax treatment has been proliferated throughout the income tax. Thus, it is pointed out that capital-gains treatment is accorded to income from a patent or invention but denied to income from copyrights. Similarly, while interest income is generally included in taxable income, interest received on State and local government obligations is exempt. Differential treatment is also noted with respect to various provisions for income saved for retirement. The extra personal exemption for blind taxpayers provides preferential treatment with respect to any given amount of income received by such individuals as compared with those who suffer from some equally disabling physical handicap.

This multiplicity of differential tax provisions, it is argued, is the result of a continuing process of attempting to provide special tax adjustments for special types of situations. The basic difficulty, it is pointed out, is in the fact that forsaking uniformity in any one case gives rise to demands for similar concessions in others. Thus, providing capital-gains treatment for the cutting of timber led to demands for similar treatment with respect to coal royalties. Excluding from an employee's income amounts put aside in a retirement fund on his behalf by his employer has led to persistant requests for tax-free reservations of income saved for retirement by self-employed individuals. The result is a highly nonuniform income-tax system which places a premium on tax-avoidance devices and increases the relative tax burden on those taxpayers who are unable to take advantage of the special provisions.

Those who are critical of this nonuniformity in the tax law argue that a major objective of tax policy should be restoring the universality of the income tax. They argue that no differentiation should be allowed on the basis of source of income, that deductions should be allowed only for the actual costs necessarily incurred in the production of the taxpayer's income, and that a single, uniform system of rates should apply to all net income.

On the other hand, it is pointed out that a truly uniform tax system might often impose severe financial hardships on taxpayers whose special situation might not be adequately reflected in general tax provisions. For example, the additional exemption allowed taxpayers 65 years of age or over is said to reflect the fact that such individuals generally must reserve a larger share of current income against illness and other financial reverses than younger taxpayers. Nonuniform tax treatment in this type of case, it is argued, serves to equalize effective tax burdens.

Moreover, it is contended that the tax law must recognize that certain types of desirable economic activity are peculiarly sensitive to the deterrent effect of income taxation. For example, prompt replacement of obsolete production equipment would often be deterred were it not for the special features of the tax law which provide for a differentially low tax on any gain which might be realized while allowing full deduction of any losses.

Other provisions of the law, it is pointed out, reflect deliberate public policy to encourage certain worthwhile activities. Thus, the recent increase in the limit on the deduction for charitable contributions reflects the efforts by the Congress to encourage private support of schools, churches, and hospitals. Providing capital-gain treatment for patent income is cited as an example of congressional recognition of the importance of encouraging technological innovation and development.

Accordingly, it is contended that if the tax law is to be an effective instrument of public policy, it must be kept flexible in order to adjust to changes in economic conditions and priorities in public policy objectives. A rigidly uniform tax system might provide greater equity but would do so at the cost of other important objectives of public policy.

D. DISTRIBUTION OF INDIVIDUAL INCOME TAX BURDENS

At the heart of much of the controversy over the structural features of the individual income tax is basic disagreement as to the appropriate distribution of the burden of the tax. Numerous proposals have been made in recent years for revision of the rate structure or personal exemption provisions in order to provide relief for the low-, middle-, or upper-income groups.

Proposals aimed at easing the relative burden of low-income individuals have called for either an increase in the personal exemption or an equivalent tax credit allowed with respect to each exemption claimed. An alternative proposal would halve the present statutory first bracket of taxable income ($2,000 in the case of single returns or separate returns of married couples, $4,000 in the case of joint returns), providing a lower starting rate, say 15 percent, on the new first bracket.

Proponents of an increase in the personal exemption contend that such an increase is required to make adequate allowance for the substantial increase in the cost of living that has occurred since the present $600 personal exemption was adopted. In addition, it is maintained that recent tax legislation has afforded tax relief primarily for middle- and upper-income taxpayers and that tax reduction for the low-income taxpayer is required to restore the appropriate overall distribution of income-tax burdens.

Some of those favoring tax reduction for low-income individuals point out that the benefits of an increase in the personal exemption would not be limited to such taxpayers. On the contrary, it is pointed out, the reduction in tax liability would be greater the greater the amount of the taxpayer's income, since the amount of the tax savings depends on the marginal tax rate to which the taxpayer is subject. Accordingly, in order to limit the benefits, it has been proposed that a flat credit be allowed against an individual's tax liability, based on the number of exemptions the taxpayer claims. For example, the recent proposal for a $20 credit per exemption was the equivalent of a $100 increase in the exemption at the present 20-percent first-bracket rate of tax.

Those opposed to an increase in the exemption, or equivalent tax credit, point out that it would result in a significant decrease in the tax base and in the number of individuals contributing to the financing of the Government through the income tax. A $100 increase in the exemption, for example, would result in an estimated decrease of 4.1 million in the number of taxable returns filed, and a reduction in income tax revenue of about $2.5 billion.

Moreover, it is argued, the present income-tax structure places undue importance on the size of a taxpayer's family in determining relative income tax liability. An increase in the exemption, therefore, would exaggerate this relationship. For example, it is pointed out that with the present personal exemption a single man with no dependents and an income of $2,889 pays the same income tax as a married person with 3 children earning almost twice as much. A $100 increase in the exemption would further increase the disparity in income which would produce the same tax liability in these 2 cases.

Finally, it is contended that tax revision should seek to increase tax-rate progression in the income tax. Under the present law, it is pointed out, a single taxpayer with a $700 income is subject to the same bracket rate of tax as a married person with 3 children earning as much as $7,778, over 10 times as much. An increase in the personal exemption would exaggerate this lack of rate progression.

The alternative proposal of halving the present first bracket of taxable income, it is contended, would concentrate tax relief in the low-income area and would avoid many of the objections raised against an increase in the personal exemption. This proposal, it is pointed out, would not result in a decrease in the number of taxpayers or in the tax base, although if the new first-bracket rate were set at, say, 15 percent, it would produce approximately the same reduction in total tax liabilities. Moreover, it is argued, this proposal would introduce rate progression for a very large number of taxpayers who under the present law are subject only to the first-bracket tax rate. Such progression, it is maintained, is necessary in order to afford the proper differentiation in tax liabilities among such individuals.

In addition it is argued that income splitting on joint returns of married taxpayers unduly favors the married individual as compared with a single person and substantially vitiates rate progression, particularly for upper bracket taxpayers. To offset these consequences without reintroducing the inequality between community- and non-community-property States, it has been suggested that married taxpayers be required to use a separate rate schedule with taxable income brackets one-half the size of the present statutory brackets. This proposal, it is alleged, would increase Federal tax revenues by $3 to $4 billion.

Other proposals for rate revision reflect the belief that the major need for revision is to ease the burden on middle and upper incomes. The principal arguments with respect to this type of burden redistribution have been presented above. In general, these proposals call for either an overall reconstruction of the rate schedule, providing for a decrease in effective rate progression above, say, $10,000 of taxable income, or for a flat, across-the-board proportional reduction in statutory rates throughout the income scale.

CAPITAL GAINS TAXATION

I. Present Law

A. General Provisions

Under present law, gains accruing on capital assets are taxed only when realized by sale or exchange of the property.[1] The term "capital assets" as defined in section 1221 of the Internal Revenue Code of 1954 includes all property held by the taxpayer except certain specified classes: (*a*) Stock in trade or property of a kind includible in inventory; (*b*) property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business; (*c*) property used in trade or business and subject to an allowance for depreciation; (*d*) real property used in trade or business; (*e*) a copyright, literary, artistic or musical composition which is the product of the taxpayer's personal efforts; (*f*) accounts or notes receivable acquired in the ordinary course of trade or business; and (*g*) certain Government obligations sold at a discount. Although depreciable and real property used in trade or business is specifically excluded from the capital asset category, net gains realized on their sale or exchange are taxable at the alternative differential rate. Net losses, however, are treated as ordinary losses (sec. 1231).

Gains realized on the sale or exchange of capital assets held less than 6 months are treated as ordinary income and are fully taxable. Special treatment, however, is afforded gains realized on capital assets held more than 6 months. For individuals, this is effected by including in taxable income only 50 percent of the excess of net long-term capital gains over net short-term capital losses. The tax is then computed at regular rates on the taxpayer's total income including this amount, with the result that the capital gain is taxed at half the marginal rate applied to ordinary income. Alternatively, a tax at regular rates is computed on all income excluding the capital gains and this amount is increased by 50 percent of the gains taken into account (i. e., 50 percent of 50 percent of the excess of net long-term gains over net short-term losses). The lower of the two computed taxes, then, becomes the taxpayer's liability.[2] In effect, the maximum rate at which long-term capital gains are taxed is 25 percent. The following table illustrates the effect of this limitation in the case of a joint return at various levels of taxable income.

Taxable income	Tax on 1 additional dollar of—		Capital gains rate as a percent of regular rate
	Ordinary income	Long-term capital gains	
	Percent	*Percent*	*Percent*
$5,000	22.0	11.0	50.0
$10,000	26.0	13.0	50.0
$25,000	43.0	21.5	50.0
$32,000	50.0	25.0	50.0
$100,000	75.0	25.0	33.3
$400,000	91.0	25.0	27.5

[1] Secs. 1201, 1222.
[2] Secs. 1201, 1202.

A somewhat similar alternative tax computation limits the corporation income tax on net long-term capital gains to 25 percent.[3]

In the case of individuals, losses realized on the sale or exchange of capital assets may be offset fully against gains and against other income up to $1,000.[4] Capital losses of corporations may be offset only against their capital gains.[5] Any loss in excess of that which may be currently offset may be carried forward as a short-term capital loss for the succeeding 5 years, to be offset against capital gains and, in the case of individuals, also against other income up to $1,000 in each of the 5 years.[6]

B. SPECIAL PROVISIONS

In general, the conceptual distinction between capital gains and ordinary income, reflected in the disparate tax treatment accorded each, is that capital gains arise from changes in the current market value of income-producing properties, while ordinary income results from the sale of goods or services which represent the end product of the taxpayer's economic activity. To implement this distinction, the statute has generally provided that only gains from the sale or exchange of a capital asset may be accorded the differential tax treatment. Gains arising without a sale or exchange or from a source other than capital assets, as defined, are generally treated as ordinary income. However, numerous exceptions to the sale or exchange-capital asset rule have been made.

In some cases, capital gains treatment has been accorded as a convenient way of providing relief to certain types of income regarded, for one reason or another, as incapable of bearing the full burden of ordinary income taxation. In others, capital gains treatment has been provided in lieu of an explicit averaging device. In still other cases, the capital gains option has been made available as an incentive device. As a result, the differential tax treatment accorded capital gains has been extended to certain types of income representing compensation for personal services, to income arising from sales of assets representing the taxpayer's stock in trade, and to amounts representing the accelerated receipt of future income. The major exceptions to the general statutory rules are described in the following pages.

1. *Real property used in the taxpayer's trade or business*

A major change in the capital asset concept was made in the Revenue Act of 1938, which excluded from the capital asset category property used in the taxpayer's trade or business of a character subject to the allowance for depreciation. Land continued to be a capital asset. The purpose of this provision was to eliminate the limitation on the deductibility of losses realized on the sale or exchange of depreciable property. It had been observed that the capital loss limitation had the effect of inducing taxpayers to retain in use obsolete and inefficient property or to abandon it, instead of selling it on the open market. If the taxpayer kept the old property or abandoned it, he would be able to recover his full cost in the form of depreciation deductions or an abandonment loss. Excluding the depreciable property from capital assets and therefore permitting full deductibility

[3] Sec. 1201.
[4] Sec. 1211.
[5] Ibid.
[6] Sec. 1212.

of losses realized on sales or exchanges of this property was expected to encourage more orderly and economical replacement practices.

Since the exclusion from capital assets of depreciable property applied to real estate improvements but not to the land on which the improvements were erected, a problem of allocation of basis and receipts between the improvement and the land existed. This problem was in part resolved by legislation in 1939 which made long-term capital losses of corporations fully deductible. Nonuniformity of treatment of gains from land and improvements persisted until the Revenue Act of 1942.

It was recognized in connection with the 1942 act that while the exclusion of depreciable property from the statutory concept of capital assets afforded the taxpayer favorable treatment in the event of losses on sales or exchanges of such property, it made gains fully subject to tax and might have seriously adverse effects on replacement practices. Sales of real and depreciable property at gains were becoming more frequent under wartime circumstances, and at the same time involuntary conversions, particularly shipping losses, were increasing.

The tax treatment of depreciable property was completely revised by the 1942 act in the light of these considerations. Section 117 (j) of the 1939 code was introduced first in the development of the act to cover only the involuntary conversion situation. The section provided that where total gains with respect to involuntary conversions exceeded total losses, the net gains were to be regarded as capital gains. Where total losses exceeded total gains, ordinary loss treatment was to be accorded the net losses. In the development of the act, the 117 (j) provision was extended to include all sales of all real property, whether depreciable or not, used in the taxpayer's trade or business.[7]

Section 117 (j) treatment was applied to the gain realized on the sale of property which had been subject to the special amortization allowances for emergency facilities during World War II. Gains realized on the sale of amortized emergency facilities under the 1950 Korean amortization provisions are taxable as ordinary income to the extent of the excess of amortization over ordinary depreciation.[8] No similar limitation on the applicability of section 117 (j) was made in 1953 with respect to gains realized on the sale of grain storage facilities, subject to 5-year amortization.

2. Timber

The Revenue Act of 1943 extended the section 117 (j) treatment to income from cutting or disposal of timber. As a result of the 1942 legislation, it was observed that a taxpayer might obtain capital-gains treatment for gains realized on the sale of timber sold outright as a stand, which qualified as a 117 (j) asset, while receiving ordinary income tax treatment with respect to income from the cutting of the timber. Moreover, gain from the sale of timber, however disposed of, was regarded as accruing over a relatively long period during which the trees matured and, therefore, not properly taxable in full in the single year in which the gain was realized.

To eliminate the discrimination against the taxpayer selling the timber under a cutting contract and to provide averaging for this lumpy

[7] Sec. 1231.
[8] Sec. 1238.

income, the Revenue Act of 1943 amended section 117 by adding subsection (k), under which taxpayers owning timber or having the contract right to cut timber from the property of another were permitted to elect to treat the net proceeds from the cutting of timber as a long-term capital gain. The same treatment was accorded to a timber owner who disposed of timber under a contract allowing him to retain an economic interest in the timber. As in section 117 (j), if losses exceed gains from disposition of the timber, the net losses are ordinary.[9]

3. Livestock

The treatment provided in section 117 (j) was specifically denied for property held for sale to customers in the ordinary course of trade or business or property includible in inventory. This limitation raised the question of the applicability of 117 (j) treatment to property which might be regarded either as used in the trade or business or held for sale to customers.

The principal type of property involved is livestock which may be used in trade or business for breeding, draft, or dairy purposes and which also may be held for sale to customers in the course of trade or business. Within a short period following the enactment of the Revenue Act of 1942, the Treasury Department had ruled that section 117 (j) treatment was applicable only in the case of unusual livestock sales such as those which would reduce the normal size of the herd or those resulting from a change of breed or other special circumstances. Ordinary income treatment was prescribed in the case of a customary sale of old or disabled animals culled from breeding herds. In 1949, a court decision held that animals used for breeding purposes whether or not sold as culls in the ordinary course of trade or business constituted "property used in the trade or business" to which section 117 (j) was applicable.

Notwithstanding this decision, the Bureau of Internal Revenue continued to apply the earlier rulings. As a result of a subsequent court decision which reiterated the 1949 court decision, the Bureau issued Mimeograph 6660, stating that section 117 (j) would be applied to sales of culls except where the animals had not been used for substantially their full period of usefulness.

Case history taken in conjunction with Bureau rulings created considerable uncertainty as to the treatment of gain on the sale of livestock. This uncertainty was largely resolved by the Revenue Act of 1951, which amended section 117 (j) to provide that property used in the trade or business includes livestock, regardless of age, held by the taxpayer for draft, breeding, or dairy purposes and held by him for 12 months or more from the date of acquisition.[10]

4. Unharvested crops

The 1951 legislation also resolved a question which had arisen under section 117 (j) as to the treatment of gains on the sale of land with unharvested crops. The Bureau of Internal Revenue had ruled that these unharvested crops constitute property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business and that, therefore, under the provisions of section 117 (j), any gain on the sale of the unharvested crops is to be separately deter-

[9] Secs. 631, 1231.
[10] Sec. 1231.

mined and treated as ordinary income instead of capital gains. Court decisions had reached conflicting positions on this issue requiring, therefore, some statutory resolution. The 1951 act provided that section 117 (j) treatment would be applicable to the full amount of the gains or losses realized on the sale of land with unharvested crops. Costs of producing the unharvested crop are not deductible as expenses. The Finance Committee report indicated that such sales are not transactions which occur in the ordinary course of business and thus should receive section 117 (j) rather than ordinary income treatment.[11]

5. Coal royalties

The Revenue Act of 1951 also extended section 117 (k) treatment for timber to coal royalties. Capital gains treatment for this type of income was intended as a relief and equalizing measure. It was argued that since most coal property leases are long-term with fixed royalty payments in terms of so many cents per ton, the lessor receives no automatic adjustment in royalties as price changes occur. It was observed that a large proportion of coal leases are old and that royalty payments have shrunk relative to the level of other types of income. It was also contended in the hearings on the act that capital gains treatment for coal royalties was necessary to remove the discrimination against coal lessors as compared with timber owners who lease their timberland.[12]

6. Lump-sum distributions from retirement plans

Since the Revenue Act of 1942, lump-sum distributions to employees from qualified pension trusts have been treated as long-term capital gains if the distributions are made within 1 taxable year from the date of the employee's separation from service. Capital gains treatment for such distributions apparently was intended as a substitute for a specific averaging device thought to be required in view of the lumpy character of the distribution. This treatment recognizes that a tax hardship might be imposed on employees whose income in the year of their retirement is greatly augmented by receipt in a lump sum of retirement benefits, if these benefits were fully taxable in the year of their receipt.

The Internal Revenue Code of 1954 extends capital gains treatment to lump-sum distributions from insured retirement plans.[13]

7. Lump-sum employment termination payments

The Revenue Act of 1951 made provision for capital-gains treatment of payments to an employee as a consideration for his releasing or assigning his contract rights to receive a percentage of the future profits of his employer, subject to certain conditions. Presumably this treatment was in recognition of the hardship which would be imposed by ordinary income-tax treatment of such lumpy income and in lieu of an explicit averaging device. The Internal Revenue Code of 1954 limited its application to previous contracts.[14]

8. Employees' stock options

Prior to 1945, if the transfer of an employee's stock option at a favorable price was found to be a reward for services, the difference

[11] Ibid.
[12] Secs. 631, 1231.
[13] Sec. 402.
[14] Sec. 1240.

between market price and the option price was held to be compensation taxable as ordinary income at the time of exercise. If the transfer was found to be merely for investment purposes, this difference was taxable as a capital gain when the stock was sold.

In 1945, a Supreme Court case ruled that the value of the option should be taxed as ordinary income at the time of exercise, and Treasury regulations were amended to provide that all stock options were compensatory in nature.

The Revenue Act of 1950 provided a set of rules allowing capital-gains treatment for "restricted" stock options in recognition of the use of such options as an incentive device for employees. Generally, income realized from such options (granted after February 26, 1945) is taxable to the recipient on the difference between the cost of the stock to him and the proceeds of the sale at the time he disposes of the stock. This rule applies where the employee exercises the option after December 31, 1949, and does not dispose of the stock within 2 years from the date option was granted nor within 6 months from the date he acquired the stock by exercising the option. If the option price was less than 95 percent but not less than 85 percent of the value of stock at the time option was granted, the difference between the selling price and the price paid for the stock under the option is divided into both ordinary income and capital gains. The excess of the value of the stock over the option price at the time the option was granted is treated as compensation and the balance is generally a long-term capital gain. If the option price at the time the option was granted was 95 percent or more of the fair market value, a sale or exchange of the stock held more than 6 months results only in a long-term capital gain or loss and no compensation is determined to have arisen.

The Internal Revenue Code of 1954 retains the general provisions relating to restricted stock options but makes certain changes to eliminate ambiguities and to provide more definite rules with respect to certain specific problems in the taxation of this form of compensation.[15]

9. Patents, copyrights, and literary, musical, or artistic compositions

Prior to the Revenue Act of 1950, the tax treatment of income from patents, copyrights, literary, musical, or artistic compositions depended largely on the surrounding facts, including the manner in which the taxpayer developing these items disposed of them. Royalties from copyrights and other artistic works were in all cases treated as ordinary income. Ordinary income treatment was also accorded the sale of royalty rights by professional writers or artists whose works were regarded as held primarily for sale to customers in the ordinary course of trade or business and, therefore, not capital assets. In the case of an amateur, case history had resulted in the treatment of royalties as ordinary income, but proceeds from the sale of royalty rights of the book or other artistic work held for more than 6 months were regarded as the proceeds from the sale of a capital asset not held primarily for sale to customers. The Revenue Act of 1950 specifically excluded from the statutory definition of capital assets all such copyrights, literary, musical, and artistic compositions for amateurs as well as professionals, regardless of the manner of their disposition.[16]

[15] Sec. 421.
[16] Sec. 1221.

In the patent area, case history has also developed a confusing set of rules. In the case of patents developed by professional inventors, the courts had ruled that these were ordinary assets constituting the inventor's stock in trade, the proceeds from which, therefore, were taxable as ordinary income. In the case of the amateur inventor, however, whether capital gain or ordinary income treatment was applicable to the proceeds from the disposition of the patent turned on the legal form of the transfer of the asset. Where lump-sum payment was received upon disposition of the patent, capital-gains treatment was generally applied. Capital-gains treatment was also generally allowed for a series of payments for the patent if the taxpayer was able to establish that such payments were merely installments on the sales price. Where the installments were found to be royalties, because the taxpayer retained a legal interest in the patent, the royalties received ordinary income treatment. Where, however, the taxpayer retained no legal interest, such royalties were frequently treated as capital gains even through the taxpayer might retain an economic interest in the patent's use.

The Internal Revenue Code of 1954 clarified the treatment of income received with respect to patents by providing that all proceeds from the sale of a patent by the inventor or a financial contributor in the early stages are to be regarded as long-term capital gains regardless of the form in which the purchase price is received.[17]

10. Oil royalties and in-oil payments

Oil royalties and in-oil payments are both ordinary income to the recipient. However, gain on the sale or disposition of such rights may be capital gains, depending on the circumstances.

Royalties and in-oil payments differ in that a royalty payment covers the entire life of the property while an in-oil payment is limited in time, money, or barrels of production. The sale of an oil royalty is generally subject to capital-gains treatment on the theory that it represents the sale of a fractional share of a capital asset. Sale of an in-oil payment, on the other hand, has generally been treated as an assignment of future income, thus giving rise to ordinary gain. Recent court decisions, however, have cast doubt on the taxability of such gains in the future, by upholding the taxpayer's right to capital-gains treatment with respect to proceeds realized from limited-period assignments of royalty interests.[18]

11. Life interests in estates

Under court rulings, the sale of a right to income for life from a trust estate has been treated as the sale of a capital asset, subject to the capital-gains provisions.[19] This permits the realization as a capital gain of the present value of a stream of future payments which would be taxable as ordinary income when received.

12. Other special provisions

(*a*) *Deferral of tax on capital gains.*—Under existing law, certain property under specified conditions may be sold or exchanged without current recognition of gain. This results in the carryover of the basis of the property sold to new property acquired and the deferred

[17] Sec. 1235. Patents held by taxpayers other than the inventor and used by them in their trade or business are depreciable business property subject to capital gain, ordinary loss treatment.
[18] Nordan, 22 T. C. 137: John D. Hawn, 23 T. C. 64.
[19] *McAllister* v. *Commissioner* (157 Fed. (2d) 235).

recognition of gain until the disposition in a taxable transaction of the new property. This "rollover" area includes (1) the sale of a personal residence which is replaced within a period of 1 year (4 years for members of the Armed Forces) or longer in the case of involuntary conversion;[20] (2) the exchange of property held for productive use or investment for property of a like kind, the gain, if any, being currently recognized only to the extent of cash or other property received in the transaction;[21] (3) an involuntary conversion, where the property is replaced with similar property within a reasonable period;[22] and (4) certain other nontaxable exchanges of stock for property in the organization of a corporation, the exchange of stock for stock of the same corporation in a recapitalization, the exchange of stock of one corporation for stock of another corporation in a merger or reorganization, and certain exchanges of insurance policies.[23]

(*b*) *Other special provisions.*—Special rules are provided to determine the taxability of gains and losses as capital or ordinary in a number of other situations. These include the specific provisions dealing with investment accounts of security dealers, sales of subdivided real estate, life-insurance annuities and endowments, bond retirements, cancellation of leases or distributorships, short sales, options, and commodity futures, and corporate distributions and liquidations.

C. HISTORY OF CHANGES IN THE LAW

The method of taxing capital gains and allowing deductions for capital losses has been altered many times since 1913.

Prior to 1922, capital assets were not explicitly defined in the law. Gains from the sale of all assets were taxable in full as ordinary income, both to individuals and to corporations. This treatment of corporate gains continued until 1942. Corporations also had the right to full deduction of losses on the sale of assets until 1933. For individuals, however, losses were not deductible at all between 1913 and 1915, were deductible to the extent of gains during 1916 and 1917, and in full from 1918 to 1921.

Capital assets were first defined in the Revenue Act of 1921, and special treatment provided for gains on sales by individuals. From 1921 until 1933, capital assets were defined as property held for more than 2 years (whether or not connected with a trade or business), but excluding stock in trade or property included in inventory. Property held for personal use or consumption of the taxpayer or his family was given capital-asset status after 1923. During the period 1922–33, 100 percent of gains and losses was taken into account, although individuals could elect to be taxed at the rate of 12.5 percent on net capital gains; this ceiling remained in effect until 1933. Long-term capital losses were deductible in full in 1922 and 1923, but between 1924 and 1933 the allowance was limited to a tax credit equal to 12.5 percent of such losses. Short-term capital losses continued to be deductible in full against ordinary income.

The Revenue Act of 1934 redefined capital assets to include all property, whether or not connected with a trade or business, regardless of the length of time held, except stock in trade or other property of a

[20] Sec. 1034.
[21] Sec. 1031.
[22] Sec. 1033.
[23] Secs. 351, 354, 361, 1032, and 1035–1036.

kind to be included in inventory, and property held primarily for sale to customers. One of the purposes of this new definition was to deny to professional traders and speculators in securities and commodities the right to deduct trading losses in full as ordinary losses. The 1934 law repealed the 12.5 percent ceiling rate for individuals and in its place substituted a schedule for taking into account 30 to 100 percent of capital gains or losses, depending on the period the assets had been held. Corporation gains continued to be recognized in full. Net gains of both included in income were taxable at the regular income-tax rates. Net capital losses could be deducted from ordinary income up to $2,000.

The Revenue Act of 1938 continued the 1934 definition of capital assets with the further exception of property used in a trade or business. This permitted individuals and corporations to charge off against ordinary income of a character subject to depreciation the full amount of loss on the sale of buildings, machinery, and other depreciable assets, although losses on land sales continued to be limited to $2,000 plus capital gains. The act also modified the 5-step schedule for recognizing various percentages of gain or loss in favor of a 3-step schedule. Gains or losses from assets held 18 months or less were called short-term and those from assets held more than 18 months were called long-term. One hundred percent of all gains and losses were recognized for corporations, while, for individuals, 100 percent was taken into account if the asset was short-term, 66⅔ percent if held 18 to 24 months, and 50 percent if held more than 24 months. The regular rates for both individuals and corporations were then applied, although individuals could elect to be taxed on their long-term capital gains at the rate of 30 percent, i. e., an effective rate of 20 percent on assets held 18 to 24 months and 15 percent if held more than 24 months. Long-term capital losses (according to the percentages recognized) could be deducted by individuals from other income, or 30 percent of the loss could be credited against the tax on other income. During 1940 and 1941 corporations could deduct their long-term losses in full, but neither individuals nor corporations could deduct their net short-term losses; these could, however, be carried forward and set off against the short-term losses of the immediately following year.

The Revenue Act of 1942 continued the definition of capital assets but excepted therefrom real property used in the trade or business of the taxpayer, introducing the special provisions for what came to be known as section 117 (j) transactions. The law divided capital assets into long and short term, depending on whether held for more or less than 6 months. Short-term capital gains of individuals and long- and short-term capital gains of corporations were included in income but only 50 percent of the long-term capital gains of individuals were taken into account. The regular individual and corporate rates were then applied, but both individuals and corporations could elect to be taxed at an effective rate of not more than 25 percent on their long-term capital gains. In determining net capital losses, all capital gains and losses (long term and short term) were considered together. Individuals were permitted to deduct net capital losses against ordinary income of the year up to $1,000 and carry forward any balance of capital loss to be applied against capital gains of the succeeding 5 years, plus $1,000 of other income. Corporations could also carry forward net capital losses for 5 years, but without the privilege of applying such loss against ordinary income of such years.

The Revenue Act of 1951 temporarily increased the alternative tax rate on capital gains to 26 percent. In addition, the 2-for-1 offset of short-term loss against long-term gain was eliminated. The 1951 act also provided for section 117 (j) treatment of sales of land with unharvested crops if held for 6 months, sales of livestock held for draft, breeding or dairy purposes and held for 12 months, and to coal held for more than 6 months before being mined.

The Internal Revenue Code of 1954 made numerous changes, mostly of a technical and definitional character. The principal substantive changes made were provisions for capital-gain treatment for patent royalties and for proceeds from the sale of subdivided real estate, subject to certain qualifications.

D. FOREIGN

While many countries of the world (including Great Britain and its Dominions) generally exempt capital gains, most European countries impose a tax on capital gains, though some of them (e. g., France) tax only those gains which arise from a business or profession. Several countries in Latin America (e. g., Argentina, Brazil, Cuba, and Venezuela) also tax capital gains.

1. British Commonwealth countries

Britain, Canada, and the countries of the Commonwealth do not as a rule tax capital gains. The concept of exempt capital gains in these countries, however, differs in many respects from that of the United States law. The British concept of casual gains, which are exempt, is much narrower than what we call capital gains. The result is that gains which receive preferential treatment in the United States are either completely exempt or fully taxed in Britain. Decisions as to the taxability of gains depends on determination by the inland revenue and on interpretations by the courts, rather than statute. A statement of the theory of the present rules is given by the recent Royal Commission: [24]

> * * * It is much less easy to state succinctly what is the present legal theory as to the taxation of realized gains upon the sale of property. Insofar as the property consists of stock in trade, there is no question but that a gain on sale enters into a computation of profit. That covers the case of the ordinary trader and his stock. But a man may make a profit from an isolated venture, without being in other respects a trader at all, or from a venture, separate from his regular business, which he does not intend to maintain or to repeat. There is nothing in the law that precludes such a profit from being taxed as his income, so long as the venture in the course of which the sale took place is itself a "trade, manufacture, adventure, or concern in the nature of trade." This seems to be the sole relevant test. The idea that a profit to be taxable must be recurrent or at any rate a profit arising from an activity that is likely to yield recurrent profits is not now part of the legal conception that is applied, however persuasive it may have seemed in the light of the fact that the tax is a tax on "annual" profits. The doctrine that now prevails may be summed up by saying that the profit from an isolated transaction in property is not as such exempt from taxation.

The Royal Commission also stated that it seemed to it that[25]—

> * * * the taxability of profit arising from what may be called the isolated or occasional profitmaking enterprise is firmly established. Thus a purchase and

[24] Royal Commission on the Taxation of Profits and Income: Financial Report (June 1955) (Cmd 9474) pp. 26–27.
[25] Ibid., p. 28.

sale of a single stock of paper by a moneylender interested in the cinema business, of 2 lots of whisky in bond by a woodcutter, and of 2 farms by a motor engineer with a sideline as partner in a land-development scheme, have all yielded a taxable profit to the revenue. So has an underwriting commission received by a man who did no other underwriting, and a commission for a bank guaranty given by a solicitor on one occasion on behalf of a company of which he had become a director.

2. Belgium

Gains and losses of industrial, commercial, or agricultural enterprises, or from the exercise of a profession, arising from the sale of assets, or any appreciation or depreciation in value which a taxpayer shows in his accounts, are taken into account in determining income liable to the ordinary income tax. Persons not "in trade" do not take gains or losses into account. Because the Belgian franc underwent severe depreciation after World War I, the purchase price of certain assets is increased by prescribed coefficients for the purpose of computing depreciation deductions or determining gain or loss on their disposition. Gains on the receipt of certain compensation payments (e. g. on requisition of property) are not taxed if the receipts are reinvested in business assets within 3 years.

3. Denmark

Gains on the sale of assets in the course of speculation or as part of taxpayer's customary activities are taxed like other income. A taxpayer is presumed to have speculated if he sells land, buildings, stocks or shares within 2 years of their acquisition. Losses on speculation are deductible only from gains on speculation. An inventor who transfers his patent rights is liable for tax thereon; 50 percent of the gains or losses from a transfer of goodwill, or leasehold of property, minerals, patents, etc., are recognizable for tax purposes; 30 percent of the profits (but not more than 30 percent of the purchase price) or losses on the sale of machinery, fittings, and working plant are taken into account.

4. Finland

Profits on the transfer of land or buildings held for less than 10 years, and the transfer of other property held less than 5 years, are includible in taxable income. Capital losses can be deducted only from capital gains.

5. France

There is no capital gains tax as such in France but capital gains (whether of an individual or a company) arising from a business or profession are liable (subject to certain relieving provisions) to the ordinary income taxes. In addition, 50 percent, of any gain made on the transfer of a controlling interest in a company is liable to surtax.

The general rule for computing business or professional profits is to compare the value of the net assets at the beginning and end of the taxation period and adjust for additions to or withdrawals of capital. In this way any capital gains or losses on a sale or transfer (including transfer on death) or withdrawal of business assets would automatically be brought into account.[26] In the case of a professional activity the profits will include any gains on the transfer of an office or of a practice.

[26] In the case of small businesses and most farms, the assessment is usually on a conventional basis (i. e., on an assumed profit and not on the basis of accounts). The administration can, however, denounce the conventional basis in a particular case (in farming cases exceptional circumstances are necessary) and insist on an assessment on actual profits. (See also par. (d).)

The chief relieving provisions are:

(a) Capital gains on the sale of fixed assets of a business which is being continued are exempt provided that the profits are reinvested in fixed assets within 3 years.

(b) Capital gains shown in the accounts as a result of a revaluation of the assets may be put into a special reserve. These gains are then not liable to tax unless they are distributed.

(c) Spreading of extraordinary income: If the taxpayer's extraordinary income, such as capital gains, exceeds his average income for the previous 3 years, the extraordinary income may be spread over a period normally consisting of the current year and the 4 preceding years.

6. Netherlands

All capital gains and losses of corporations are taken into consideration. In the case of an individual, capital gains and losses arising from a business or profession and profits exceeding 500 florins ($130) from speculation are included. Losses from speculation may be offset only against capital gains of the same year. Capital gains on the transfer of an interest in a company or partnership are regarded as income if the transferor owned more than 25 percent of the capital at any time during the preceding 5 years. On the liquidation of a company, any sums received by a shareholder in excess of his paid-up capital are treated as income.

7. Norway

In computing taxable income, there is taken into account profits and losses on the sale of a business or business assets, and property other than securities. The profit is exempt if the property was held for 10 years or more, unless purchased for speculation. The law specifically exempts profits from speculation in securities.

8. Sweden

In computing taxable income there is taken into account profits and losses on the sale of property acquired by purchase, exchange or similar means. In the case of immovable property the gains are taxable if the property is held for less than 10 years, and in the case of movable property, if held for less than 5 years. Any gains made in the course of business are liable, irrespective of how long the property is held. Capital losses (other than losses which are personal living expenses, e. g., on the sale of a private motor car) may be deducted but only against capital profits.

9. Switzerland

In computing taxable income for Federal income tax, there is taken into account profits or losses on the sale or transfer or revaluation of assets of any business which is required to keep accounts, meaning generally commercial and industrial concerns. Some of the Cantons levy specific taxes on capital gains.

II. ISSUES AND PROPOSALS

The present tax treatment of capital gains and losses has been subject to continuing criticism on both economic and equity grounds.

Proponents of more liberal treatment argue that the present system imposes a significant barrier to the mobility of investable funds. Moreover, they maintain that the present treatment is inequitable in that it fails to make an adequate distinction between capital gains and losses and ordinary income and losses. On the other hand, those favoring elimination of the present preferential treatment of capital gains point out that the differences between capital gains and ordinary income do not require preferentially lower taxes on the former and that there is no objective evidence available to substantiate the contention that capital transactions are significantly deterred by the present tax structure.

A. ECONOMIC ISSUES

The basic economic problem in the taxation of capital gains stems from the realization principle underlying the present law. Capital gains are taxable, not as they accrue, but only when the capital asset is sold or exchanged. The timing of the sale or exchange, and therefore realization of the gain, is at the discretion of the taxpayer. Whether or not the gain is realized depends on the taxpayer's choice between (*a*) obtaining a larger income from the asset in the future, or (*b*) immediately obtaining the commuted value of this future income. In the case of ordinary income, on the other hand, no such choice generally faces the taxpayer. In general, the benefits of such income can be enjoyed only when the income is actually realized, and such realization itself gives rise to tax liability.[27]

The imposition of tax on realized capital gains has the effect of reducing the present value of the future income, i. e., the capital sum realized. Accordingly, the tax tends to weigh the taxpayer's choice in favor of retaining the asset and enjoying its enhanced future returns.

The weight of the tax factor in this choice between realization or nonrealization of accrued capital gains varies considerably among investors. Very often, factors other than tax considerations are determinant. All other things being equal, however, the holder of an appreciated capital asset will not sell or exchange it and realize the gain unless (*a*) he has found an alternative investment sufficiently preferable to the present holding to offset the tax and other costs of the exchange, or (*b*) he anticipates a decline in the market value of his present holding at least equal to the reduction in proceeds from the sale by the amount of the tax liability.

This tax consideration may be illustrated in the case of an investor with 100 shares of corporation X bought at $50 and now selling at $80 per share. Assume that the X stock is now yielding 6 percent on the basis of its current price and the taxpayer is considering a shift to another stock yielding 7 percent on the basis of its current price. At the present tax rate of 25 percent, the net proceeds after the tax from the sale of the X stock would be $7,250 ($8,000 minus 25 percent of $3,000) which, if invested in the new stock, would yield sufficiently more than the yield in the securities sold ($507.50

[27] The Senate Finance Committee observed, in its report on the revenue bill of 1938, that "There is an essential difference between income derived from salaries, wages, interest, and rents and income derived from capital gains. It is always to the advantage of the taxpayer to receive the first class of income no matter what the rate of tax as long as it is less than 100 percent. On the other hand, the tax in respect to capital gains is optional—the taxpayer is not obliged to pay any tax unless he *realized* a gain by the *sale* of the asset * * *." [Italics added.] (S. Rept. No. 1567, 75th Cong., 3d sess., p. 6.)

compared with $480) to justify the switch. The switch would also be justified if the taxpayer expected his present holdings to remain at their present price while the new stock was expected to rise in price by 10.3 percent or more. Similarly, sale of the present holdings would be justified if their price were expected to decline by $7.50 or more per share (from $80 to $72.50 or less).

It is evident that the higher the rate of tax, the greater will be the deterrent effect of tax considerations on investment transfers. Accordingly, proponents of more liberal tax treatment of capital gains argue that a reduction in the rate would serve to "unlock" a substantial volume of investable funds which have been "frozen" into investments by the capital gains tax.

This problem of frozen investments is alleged to be particularly acute today in view of the substantial increase in property values which has occurred over the past decade and a half. This rise reflects both a general rise in prices and the continuing increase in the level of business activity. Accordingly, sales or exchanges of capital assets are likely to involve the realization of very large capital gains measured in money terms and, consequently, very heavy capital gains tax liabilities. Many of the investors whose funds are "locked in" these appreciated assets, it is argued, would be willing and able to assume the risks involved in financing the high-risk ventures which are so important in sustaining the dynamic quality of the economy. More liberal capital gains treatment, it is maintained, would encourage such investors to transfer their investable funds in this manner. In addition, it would offer inducements to potential investors in the broad middle-income range to increase their holdings of corporate securities, particularly the relatively low-risk issues which would become available as present investments shifted to the riskier outlets.

Finally, those in favor of liberalizing capital gains treatment argue that the present system serves to promote economic instability. In times of rising prices, investors tend to set a higher reservation price in order to recoup the tax paid to the Government as a necessary cost of transferring from one investment to another. Capital assets, therefore, tend to be withheld from the market, thereby restricting the supply offered for sale and forcing prices to rise still further. The reverse occurs when prices are falling, the net effect being to accentuate price swings of capital assets.

Opponents of preferential treatment for capital gains argue that the locking in effect of the present tax system has been greatly exaggerated. In the first place, it is maintained that tax considerations are only one of a large number of considerations which enter into decisions with respect to asset transfers. Reference is made to a recent survey which showed that for 70 percent of the security holders surveyed, tax considerations were of no, or at best moderate, importance in their investment decisions.[28] It is also pointed out that available statistical data tend to confirm the conclusion that considerations other than taxes are of primary importance in investment management. These data show a close relationship between capital gains and losses and changes in security prices. Increases in stock prices are generally accompanied by increases in the excess of capital gains over losses reported on tax returns, regardless of differences in tax

[28] New York Stock Exchange Department of Public Relations and Market Development, The Public Speaks to the Exchange Community (February 1955), p. 37.

treatment of gains. Decreases in stock prices are generally accompanied by increases in the excess of losses over gains.[29]

Moreover, it is argued that the impact of capital gains taxation on investment decisions has been misconstrued by proponents of more liberal treatment. To analyze this impact, it is necessary to recognize that individual investors may be classified, broadly speaking, into two groups. The first includes those who are income- and security-minded, who tend to balance the current income yield of their investments against the risk of capital loss and who are little concerned with capital appreciation potentials of their investments. For this group, obviously, the specific tax treatment of capital gains is of little consequence in investment decisions, although the capital loss provisions may be quite significant. The second group consists of those who are primarily motivated by the desire for appreciation in the value of their investments. For such individuals, the present preferential treatment of long-term capital gain is an important tax consideration which serves to encourage shifting out of conservative types of investments into more speculative ventures. Accordingly, it is maintained that the present provisions do not deter the mobility of venture capital. Moreover, a substantial mitigation of the present liberality in capital gains taxation would not significantly affect the transferability of investments for the latter group of taxpayers.

It is also claimed that the effect of further liberalizing the capital gains provisions on the amount of capital assets offered for sale would be of short duration. Any given reduction in the tax rate, it is argued, might free some investments for which transfers now are marginal, but once these transfers were made, no further increase in the level of capital asset transactions would result, unless further rate reduction were provided. The "unfreezing" effect, therefore, would be one-shot. A more substantial one-shot effect, it is claimed, would result from announcing a substantial increase in the tax rate to take effect, say, in 6 months.

Finally, it is argued that the major tax deterrent to realization of assets with accrued capital gains is the fact that these gains are not taxed under the income tax upon the transfer of the assets through gift or at time of death. Accordingly, it is argued that particularly in the case of elderly taxpayers, there is a substantial incentive to defer realization of such assets. Provision for constructive realization on transfers by gift or at death, it is argued, might be expected to have a substantial effect in freeing currently immobilized investments.

B. EQUITY ISSUES

Proponents of preferential income-tax treatment for capital gains maintain that gains derived from the disposition of property differ in a number of fundamental respects from ordinary income. These differences are such that capital gains cannot be expected to bear the full weight of progressive income taxation.

In the first place, it is argued that a capital gain is the increment in market value of a capital asset which reflects an increase in the present value of the future income stream produced by the asset. Regardless of the factors which produce this increase in value, the imposition of

[29] These data are presented in the Staff Report to the Committee on Banking and Currency, U. S. Senate, Factors Affecting the Stock Market, 84th Cong., 1st sess., p. 81.

a tax on the realization of the gain represents a capital levy, since the tax liability precludes replacing the asset with an equally valuable asset unless funds are diverted from other sources. While it may be true that the gains would have entered the taxpayer's taxable income as they accrued were it not for the "realization" principle in the law, they have nevertheless been incorporated in the taxpayer's capital by the time of realization. Accordingly, the sum of the capital values at the taxpayer's command immediately following the disposition of the property is less by the amount of the tax than that immediately preceding the sale.

It is also argued that capital gains typically accrue over more than one income tax accounting period. It is obviously unfair, therefore, to tax such gains at progressive rates in the year of realization. To do so might often result in a greater total tax liability than if the gains had been subject to tax each year as they accrued.

It is also argued that in view of the fact that capital gains are generally realized only incidentally to transfers of investment from one capital asset to another, such gains are not available to finance consumption expenditures in the same way or to the same extent as income from wages, salaries, rents, or dividends. Accordingly, they represent less ability to pay taxes than the latter types of income.

Moreover, it is maintained that capital gains do not represent an increase in the real product or income of the community. Such gains reflect merely relative changes in the market valuation of assets rather than additions in real terms to the total amount of goods and services currently available for consumption or investment purposes. Accordingly, taxes on such gains represent a transfer from the private to the Government section of the economy, not of claims to the economy's current product (income) but of claims to its future product (capital).

Finally, it is pointed out that capital gains frequently reflect only general increases in prices. Such gains are "illusory" in that they do not measure changes in real terms in the taxpayer's economic position. As such, therefore, they represent no addition to the taxpayer's ability to pay taxes. Recognition of the fact is found in section 1034 of the Internal Revenue Code of 1954 [30] which permits the tax-free transfer of gains from the sale of a personal residence into another residence.

Opposed to this view is the contention that the basic concept of income which should underlie income taxation does not provide any basis for distinguishing the tax treatment of capital gains from other types of income. Income, it is argued, is properly defined as "* * * the money value of the net accretion to one's economic power between two points of time." [31] Another way of expressing this concept is that income is "the algebraic sum of a person's consumption and the change in value of his property rights during a period." [32] These definitions specifically include appreciation in capital assets.

Moreover, it is argued capital gains represent as much ability to pay taxes as equal amounts of income from other sources. Any income, it is pointed out, may be regarded as a fund which the recipient may allocate between current consumption and personal investment as he sees fit. The fact that income from some types of property transactions typically is reinvested by the recipient reflects merely a pattern of behavior but not a lack of taxpaying ability.

[30] Sec. 112 (n) of the Internal Revenue Code of 1939.
[31] R. M. Haig, The Federal Income Tax (New York 1921), p. 7.
[32] Henry C. Simons, Personal Income Taxation, University of Chicago Press, 1938, pp. 51 and 125.

Many opponents of preferential treatment of capital gains would concede that where the gains have accrued over a number of years it is not appropriate to tax them as if they had in fact accrued only within the current income period. They maintain, however, that the present preferential rate treatment is an unsatisfactory approach to this problem of "bunching," since any specific rate, e. g., the present 25 percent, bears no necessary relationship to that which would have been applicable had the gain been taxed as it accrued.

The "illusory" character of capital gains arising from changes in price levels, it is contended, is not an adequate basis for preferential treatment of this type of income. Incomes from nonproperty sources frequently reflect price-level changes rather than changes in real terms in the recipient's economic status. To accord more favorable treatment to capital gains than to other income on this basis, it is maintained, is manifestly unjust.

It is also contended that the fact that capital gains in the aggregate do not measure an increase in the economy's total product is not relevant in determining the taxability of these gains in the hands of their recipients. Income taxation is based on the principle of ability to pay, which in the case of any one taxpayer is enhanced by the realization of a capital gain.

Opponents of preferential treatment of capital gains maintain that the benefits of this treatment are concentrated among upper income taxpayers. They point out that the latest available data from tax returns [33] show that 51 percent of total net gains [34] reported in 1952 were on returns with adjusted gross incomes of $20,000 or more. Since over 90 percent of these gains were long term, i. e., realized on assets held more than 6 months, they were subject to a maximum rate of tax of 25 percent, in most cases resulting in a tax substantially less than that which would have been imposed on equal amounts of salaries, dividends, rents, and other types of income. The result of this preferential treatment, it is maintained, is to impose a significantly heavier tax burden on taxpayers who derive little or no income from capital transactions.

Finally, it is maintained that preferential taxation of capital gains provides a formidable impetus for converting ordinary income into capital gains. The opportunity to do so, however, is almost nonexistent for ordinary wage and salary earners who comprise the bulk of the taxpayers. Business people, on the other hand, have been able to devise a wide array of income arrangements to take advantage of the capital gains provisions. As a result, capital gains treatment has become one of the most impressive loopholes in the Federal revenue structure.

C. PROPOSALS FOR REVISION OF CAPITAL GAINS TAXATION

The problems noted in the taxation of capital gains have called forth a very wide range of proposals for revision. Most of these proposals are addressed to mitigating the adverse economic consequences of the present system while some are primarily concerned with making it more equitable. In addition to proposals calling for major substantive revision, a number of suggestions have been made for more

[33] Statistics of Income, pt. 1, 1952.
[34] Total gains on a 100-percent basis less total losses on a 100-percent basis.

limited modification of specific aspects of the present system. Only the former proposals are described below.

1. Downward revision of rate and holding period

Apart from proposals for complete exemption of capital gains, perhaps the most frequently advocated revision is a decrease in the present tax rate and the holding period requirement for long-term gain treatment. A 10 to 15 percent rate coupled with a 3-month holding period, it is argued, would significantly increase the volume of capital transactions, particularly in corporate securities. Accordingly, the benefits of increased mobility of investable funds would be obtained at a minimal revenue loss or even, according to some, a revenue gain.

This proposal is opposed on grounds that it would further increase the unfairness of the present system, increase incentive for conversion of ordinary income into capital gains, and result in a significant loss in revenue which would have to be made up by additional taxes on other sources of income. Moreover, it is argued, the proposal would not result in a continuing increase in the level of transactions but would have only an initial impact on freeing immobilized funds.

2. Step-scale reduction in tax rate

Another frequently offered proposal is to provide for graduated reduction of the tax rate applicable to realized capital gains, according to the length of time the asset is held before realization. This proposal, it is held, would mitigate the impetus toward converting ordinary income into capital gains, since most devices for so doing can be effectively employed only over relatively short periods of time. Assets distributed through liquidation of a collapsible corporation, for example, would have to be held for a relatively long period of time if maximum benefit from this proposal were to be obtained. Such assets, however, are generally promptly realized.

On the other hand, it is pointed out that this proposal would offer increasing incentives to hold capital assets and would therefore serve to decrease the mobility of venture capital.

3. "Rationalization" of the capital-gains area

A proposal currently receiving attention calls for a careful review of the entire area of capital-gains taxation in the present law for the purpose of eliminating those transactions and receipts which are not true capital gains. Preferential treatment under the capital-gains provisions, accordingly, would be confined to gains realized on the sale or exchange of a much narrower category of assets than at present, principally corporate securities. Other types of income currently receiving capital-gains treatment, such as those representing compensation for personal service (distributions from retirement plans, stock options, patent royalties), gains from transactions involving inventory-type assets (coal royalties, cutting of timber, livestock), and anticipation of future income (in-oil payments, life interests in estates) would be subject to ordinary income treatment or whatever preferential treatment specifically accorded with the special circumstances attendant on such receipts.

The principal objection raised to this proposal is that it would be virtually impossible, as a practical matter, to draw a line distinguishing the so-called true capital gains from the wide range of other income now receiving capital treatment. The concept of a capital gain as different from ordinary income, it is maintained, is fuzzy, pertaining not so much to the kind of income as to the circumstances under which the income is received. Even strict adherence to the general qualifying rule in the present law, the capital asset-sale or exchange rule, would offer only a partial guide in making the required determination, since it would still leave open the question of what assets were to be included as capital assets.

4. The "roll-over" approach

Proposals have been made to provide for tax-deferred exchanges of nonbusiness capital assets held in an individual's personal investment account in a manner similar to that now provided for gains on the sale of personal residences. Taxation of gains would be deferred until final realization of the asset, either by diversion of the proceeds to consumption or investments of an entirely different character. Realization would also be provided for at the transfer of the property by gift or at death, or even at the election of the taxpayer. In general, an investor would not be taxed if the gains on the sale of an eligible asset were reinvested in similar assets within the same income period. A tax would be imposed, at ordinary income rates, on that portion of the gains not so reinvested. Capital losses could be carried over without limit for offset against capital gains.

This proposal, it is maintained, would completely eliminate the deterrent of current taxation on transfers of investable funds. Moreover, though it would afford some benefits to taxpayers realizing gains by virtue of deferral of tax, it would nevertheless provide for complete taxability as ordinary income for all gains realized by the taxpayer.

Practical problems of administration and enforcement are suggested in criticizing this proposal. Proponents, on the other hand, maintain that the proposal would involve little more difficulty than the present law in compliance and administration.

5. Averaging

It is contended by some that the only major justification for special tax treatment of capital gains is the fact of their accrual over more than one income period. Accordingly, the only appropriate special provision is some sort of averaging device.

A wide variety of averaging proposals have been made. A recent suggestion [35] outlines a relatively simple scheme which would be applicable to a limited category of income and loss items, principally those which typically are realized in a single year although accruing over a number of income periods. Under this proposal, the taxpayer would be allowed to credit against the tax due on the full amount of his income in the current year the difference between (*a*) the taxes actually paid during the past 5 years (including the current year) and (*b*) the taxes which would have been paid had the amount of the bunched income or loss realized in the current year been received in equal annual installments over the 5-year period.

The principal objection raised against averaging plans of this sort is the practical one of administrative and compliance difficulties. The taxpayer would be required to maintain his tax records of the preceding 4 years and, in effect, to recompute the taxes for each of these years in determining his current year's net tax liability. On the administrative side, the Internal Revenue Service would be required to keep all tax returns open for the 4 years preceding the current

[35] Joseph A. Pechman, "A Practical Averaging Proposal," National Tax Journal, vol. VII, No. 3, September 1954, pp. 261–263.

year and would experience a significant increase in audit work. These difficulties, it is maintained, would arise under virtually any averaging proposal which attempted to determine tax liability on realized gains as if realization had occurred as the gains accrued.

6. Taxation of capital gains on an accrual basis

Since the realization principle in the present law has been generally identified as the principal source of difficulty in capital gains taxation, the taxation of gains on an accrual basis has been proposed as an ideal solution. Under this proposal, taxable income would include the net change in the value of the property owned between the beginning and end of the taxable year, whether or not realized. Tax at ordinary income tax rates would be applied to such changes in value. Where net capital losses accrued over the year, they would be deducted in full from ordinary income. This approach would also eliminate the problems resulting from the lack in the present law of a constructive realization on transfers by gift or at death.

Numerous objections are raised against this proposal. In addition to the difficulties attendant upon establishing reliable values for property in the absence of a sale or exchange, the proposal would also frequently result in forced realizations in order to provide the means for payment of the tax. Moreover, this treatment would eliminate the present tax bias in favor of so-called growth investments as compared with safer income investments, and would, in fact, introduce an opposite bias.

7. Liberalization of loss offsets

The present limitations on the deductibility of capital losses are often cited as one of the principal tax barriers to direct investments by individuals in capital assets, particularly corporate securities. Most individuals, particularly those of moderate means, it is alleged, are primarily concerned with current income and safety in their personal investments. The limited offset of capital losses against ordinary income does not provide adequate safeguard for the risks attendant upon investment in securities and certain other capital assets.

Moreover, it is maintained that the current limitations on loss offsets frequently impel end-of-the-year sales of appreciated investments for the purpose of absorbing losses sustained earlier in the year. Tax-motivated sales of this character do not contribute to sound portfolio management.

Accordingly, an increase in the amount of ordinary income against which capital losses may be offset is frequently urged. In addition, a 2-year carryback is suggested in order to provide the same averaging period for capital gains and losses as is available for operating gains and losses.

Opponents of liberalization of the loss-offset provisions argue that in addition to the potentially very large revenue losses which might be involved, there is little occasion for such liberalization so long as capital gains continue to receive preferential treatment. A $5,000 ordinary income offset, such as frequently proposed, for example, would permit the elimination of income tax on ordinary income up to $30,000 under the present carry-forward arrangements. Capital losses in this amount, therefore, would be deductible at rates ranging up to 91 percent, whereas an equal amount of long-term gains would be taxable at a maximum rate of 25 percent.

TAXATION OF INCOME FROM NATURAL RESOURCES

I. Present Law

The tax law contains several special provisions for the treatment of income derived from natural resources. Generally under the law net income from business activity is determined as the difference between the taxpayer's total receipts or gross income and deductions for the cost of producing the income. The usual deductions are related to the actual monetary costs of the taxpayer. In the case of wasting assets, such as depreciable property, the tax-free recoupment of investment costs is allowed through deductions designed to spread the full costs over the economic life of the asset. Owners of natural resources are accorded a number of optional provisions with respect to their capital costs. In recognition of the wasting character of mineral deposits, a special deduction, known as percentage depletion, is allowed which need bear no relationship to actual costs. Mineral producers may also elect to recoup capital costs currently as they are made rather than being required to deduct them over the life of the asset, and timber producers may elect to treat much of their profits as capital gains rather than ordinary income subject to ordinary tax rates.

A. Depletion Allowances

Capital invested in natural resource properties may be recovered tax free through depletion allowances. For mineral properties these allowances are computed according to a cost depletion or a percentage depletion method, the taxpayer being required to take the higher of the two.[1] To compute allowable depletion under the cost (or unit) basis for either minerals or timber, the adjusted basis of the property which would be used for determining the gain upon the sale of such property is divided by the total estimated remaining units (i. e., barrels of oil, tons of ore, board-feet of lumber) and the result is multiplied by the number of units sold during the year.[2] Cost depletion deductions are exhausted when the adjusted basis of the property has been reduced to zero.

Allowable depletion under the percentage depletion method is computed as a specified percentage of gross income from the property but not more than 50 percent of the net income therefrom.[3] Although allowable percentage depletion serves to reduce the basis of the property for purposes of determining gain or loss upon sale, exhaustion of basis or the absence of any original basis does not preclude further percentage depletion allowances, since these are related to the income from the property rather than to actual investment costs. Accordingly, percentage depletion allowances may be claimed with respect to the income from a property the basis of which has been completely written off through prior cost or percentage depletion.

[1] I. R. C., secs. 611-613.
[2] Regulation 118, sec. 39.23 (m)-2.
[3] I. R. C., sec. 613.

The percentage depletion rates prescribed by the law are as follows:[4]

(1) 27.5 percent—oil and gas wells.

(2) 23 percent—sulfur and uranium, and (if mined in the United States) asbestos, bauxite, lead, manganese, mercury, nickel, platinum, tin, tungsten, zinc, and 27 other minerals.

(3) 15 percent—certain clay, asphalt, and metals not covered by (2).

(4) 10 percent—asbestos (not covered by (2)), coal, lignite, and 4 other minerals.

(5) 5 percent—brick and tile clay, gravel, sand, rough stone, etc., and brine well products.

(6) 15 percent—all other minerals except soil, sod, dirt, turf, water, or mosses, or minerals from sea water, the air or similar inexhaustible resources.

Two exceptions are made for this last group. Some of these minerals are also listed in (2) above, if produced in the United States. All of these minerals are, in addition, subject to a use test, i. e., they may be restricted to the 5-percent rate when used for purposes comparable to common sand, gravel, or rough stone.

Depletion allowances are generally available to every person who has an economic interest in and receives income from the exhaustion of a natural resource, the total allowances being apportioned among the various parties in interest. Such allowances, however, may not be claimed by the taxpayers whose economic interests in depletable properties are indirect, such as the rights of shareholders or creditors of a corporation which owns the mineral properties.

The original income-tax legislation provided a reasonable allowance for depletion, not to exceed 5 percent of gross income, for wasting mineral assets. This was later changed to a more specific allowance of depletion based on the cost or 1913 value of the property. Allowances in excess of cost depletion were first granted in the form of discovery depletion in 1918 as a measure to stimulate mineral exploration for war purposes and to lessen tax burdens on small-scale prospectors who made discoveries after years of fruitless search. Discovery depletion deductions allowed the discoverer of any new mineral deposit to recoup not only his costs but also the materially larger appreciated value of the property at the time its profitability was established. In 1921, disturbed by the extent to which large discovery depletion deductions were being used to offset other income, the Congress limited annual discovery depletion to the amount of net income from the mineral property; in 1924, it further lowered this limitation to 50 percent of net income.

Discovery depletion was eliminated for oil and gas properties in 1926, and for metals, sulfur, and coal in 1932, by substitution of allowances based on a percentage of gross income; the 50 percent of net income limitation was retained. Percentage depletion was gradually substituted for discovery depletion on other minerals, until in 1954, discovery depletion was eliminated altogether. The original percentage depletion rates for oil and gas and metals were in general fixed at levels designed to afford these industries approximately the same total annual depletion which they had been allowed under discovery depletion. The percentage depletion rates on coal, sulfur, and

[4] Sec. 613.

other nonmetallics were not based on industry experience under prior discovery depletion allowances but were selected to provide tax relief and incentives deemed suitable by the Congress in view of the rates accorded oil and gas and metals. Subsequent legislation increased these rates in numerous cases.

B. EXPLORATION AND DEVELOPMENT COSTS

In addition to depletion allowances, the tax law also provides special treatment for certain capital expenses incurred in bringing mineral properties into production. Sections 615 and 616 of the 1954 Revenue Code permit the taxpayer either to write off currently as incurred the costs of exploration and development for mineral deposits (except oil and gas wells) or to set these costs up as deferred expenses to be deducted ratably as the deposit is exhausted. Included are expenditures to ascertain the existence, location, extent, or quality of any ore or mineral deposit, or for shafts, tunnels, raises, stripping, drainage, and other items attributable to the development of the mine or deposit until it reaches a level of full production. Deductions for exploration expenditures are limited to $100,000 per year for not more than 4 years. No similar limitations are imposed on deductions for development costs.

Section 263 (c) of the 1954 Revenue Code affords a similar option for oil and gas operators either to capitalize or to write off as current expense their so-called intangible drilling and development costs of wells. The expenses currently deductible include such items as labor, fuel and power, materials and supplies, tool rental, repairs of drilling equipment, etc., incurred during the drilling of wells and their preparation for production. There is no limit on the amount of such outlays which may be deducted.

The current expensing deductions for mine development expenditures and exploration costs were first granted in the Revenue Act of 1951, which limited the annual deduction for exploration expenses to $75,000; the 1954 Code raised this limit to $100,000. Expensing of intangible drilling and development costs of oil and gas wells has existed continuously since an administrative ruling under the Revenue Act of 1916; a concurrent resolution of Congress in 1945 assured its continuance, and finally an express statutory provision was incorporated in the Internal Revenue Code of 1954. To some extent, exploration costs of oil and gas wells are also currently expensed through loss deductions which are allowed by regulations on exploration projects that prove unsuccessful and are dropped. However, geological and geophysical expenditures resulting in the acquisition or retention of properties are not deductible as ordinary expenses, but must be capitalized.[5]

The immediate deducting or expensing of the capital costs incurred in the exploration and development of mineral properties means that these costs are never included in the adjusted basis of the properties, which is recoverable through cost depletion. Broadly, these deductions are in lieu of cost-depletion deductions. However, the expensing of these costs does not serve to reduce percentage-depletion allowances, since these are computed only with reference to the income from the property.

[5] I. T. 4006, 1950-51 C. B. 48.

C. OTHER SPECIAL TAX PROVISIONS

A number of other specific provisions afford special tax treatment to taxpayers in the extractive industries. For example, recipients of loans or grants from the United States for the encouragement of exploration, development or mining of critical and strategic minerals or metals for national defense may exclude such loans or grants from income.[6] Although this provision was made in the Excess Profits Tax Act of 1950, it is applicable to both the corporate normal tax and surtax as well.

Special treatment is also accorded income arising from certain types of timber and coal-mining operations. A taxpayer owning timber or the contract right to cut timber for a 6-month period prior to the beginning of the taxable year in which he cuts the timber may elect to treat the cutting of the timber as a sale of the timber itself, the gain to be taxed at capital-gain rates.[7] A taxpayer owning timber or coal for a period of 6 months before its disposal who retains an economic interest in the coal or timber after its disposal is permitted to treat the royalties received as capital gains; if the net result is a loss, it may be treated as an ordinary loss.[8] This provision as applicable to timber was added in 1943 and extended to coal in 1951. In 1954, the election to treat income from timber as a capital gain was extended to producers of Christmas trees.

D. FOREIGN TREATMENT

Aside from the United States, only a few countries grant a special concession unrelated to cost, by which the taxpayer is allowed to reduce income by a percentage of the gross receipts or net income from the mine. Important examples are Canada, Australia, and Southern Rhodesia.

Canada has several special provisions applicable to oil and gas and mining that are somewhat similar to United States provisions, although there are important differences. Canada allows percentage depletion for oil and gas and certain nonbedded minerals usually at the rate of 33⅓ percent (40 percent for gold and 10 cents a ton for coal) of net profits.[9] Stockholders may also claim a depletion allowance of 10 to 20 percent on dividends received from certain mineral-producing corporations.[10] Canada further allows a deduction as a current expense of outlays for exploration, discovery, and development of mines or exploring or drilling for oil or gas,[11] and grants a complete 3-year exemption for new mines opened between 1946 and 1957.[12]

Australia [13] and Southern Rhodesia [14] have percentage depletion allowances. In the former, the allowance amounts to 20 percent of the net income from specified strategic metals while in Southern Rhodesia it is 10 percent of the gross value of output of gold and silver and 2½ percent for base mineral mining.

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[6] I. R. C., sec. 621.
[7] I. R. C., sec. 631 (a). The purpose of this provision is to give the taxpayer the benefit of the capital-gain rate which he would get if he had sold the timber for cutting rather than cutting it himself.
[8] I. R. C., sec. 631 (b), (c). The purpose of this provision is also to give the taxpayer the benefit of the capital gain rate. Such a transaction prior to 1944 was treated as a lease rather than a sale.
[9] Income Tax Act, sec. 11 (1) (b); Regulations, secs. 1201–1203.
[10] Income Tax Act, sec. 11 (2); Regulations, secs. 1300–1302.
[11] Income Tax Act, sec. 11 (1) (6); Regulations, sec. 1205; Laws 1949 (2d sess.), ch. 25, sec. 53.
[12] Income Tax Act, sec. 82 (5) (6).
[13] Income Tax Assessment Act, sec. 23A.
[14] Southern Rhodesia Statutes, 1952, ch. 47; 1953, ch. 41.

Australia has additional provisions which exempt (1) income derived by a company from the sale of domestic gold and dividends received by shareholders of such a company,[15] (2) income derived from a mining property operated principally for gold or gold and copper,[16] (3) income from uranium mines, [17] and (4) income (including dividends paid out of such income) derived by a bona fide prospector from the sale or transfer of rights to mine in a particular area for numerous specified minerals.[18]

II. Issues in the Taxation of Income From Mineral Resources

The basic issue in the taxation of income from mineral resources is whether the economic gains which presumably are derived from tax incentives for natural resource development outweigh equity and revenue considerations in the Federal revenue system. While there is substantial agreement as to the desirability of using public policy to encourage private development of the extractive industries, the primary problem is to determine the most effective, efficient, and economical type of public program to this end.

A. ARGUMENTS FOR CONTINUING THE PRESENT PROVISIONS

Those in favor of the present tax provisions maintain that because the value of a mineral property generally exceeds, often by significant amounts, the actual cash or property investment in its development, cost does not represent an adequate basis for computing depletion allowances. The appropriate capital value on which such allowances should be based, rather, is measurable by the price which the taxpayer could obtain for the developed property. It was on this basis that discovery-value depletion was based. However, since discovery-value-depletion allowances involved thorny problems of valuation, percentage depletion allowances, which in the case of oil and gas are believed closely to approximate discovery-value allowances, are regarded as appropriate substitutes.

Proponents of percentage depletion point out that in the absence of such allowances, the tax law would involve a much greater impetus than now exists for the taxpayer who discovers and develops mineral properties to sell them rather than to operate them himself. Sale of the property would involve capital-gains-tax liability on the commuted value of the proceeds from gradual liquidation of the property over time. This commuted value, which would be taken as the basis of the property by the purchaser, would be written off under the cost-depletion method, the allowances under which would exceed percentage depletion. Accordingly, it is argued that the Government would obtain little, if any, net revenue gain from elimination of percentage depletion and would encourage selling out of properties rather than their operation by those discovering them. This would undoubtedly result in an increasing concentration of mineral properties in the hands of fewer and fewer producing companies, with attendant adverse implications for the competitive structure of the economy.

[15] Income Tax Assessment Act, sec. 23 (c), 44.
[16] Ibid., sec. 23 (o).
[17] Ibid., sec. 23D.
[18] Ibid., sec. 23 (p).

Others favoring the continuation of the present system of allowances would agree that percentage depletion may be excessive in a literal accounting sense. They argue, however, that whatever excess is allowed represents a necessary incentive to mineral producers for continuing exploration and development activity. They point out that substantial amounts of resources must be devoted to such activities which only in a small fraction of cases result in a profitable property. Because of the inordinate degree of risk involved, special incentives must be offered if the economy's demand for natural resources is to be met adequately.

Many of the mineral resources with respect to which percentage depletion is allowed, it is pointed out, are basic to the Nation's defense. It is essential, therefore, to keep these industries operating vigorously and profitably in order to insure adequate domestic supplies in the event of war. The elimination of percentage depletion, it is argued, would require a substantial increase in the prices of mineral output to prevent a substantial contraction of mineral production. Since these prices are largely determined in a world market, however, it is unlikely that the necessary increases would be forthcoming. The result would be dependence on foreign sources of supplies, which would leave the Nation in perilous circumstances if defense requirements were suddenly increased.

Moreover, it is argued, percentage depletion allowances are an important source of the funds required to finance the development and exploitation of mines and wells. Small, independent producers, particularly, would be hard hit by elimination of these allowances and would be forced to curtail their exploration and development programs to a considerable extent. This would be especially true in the case of the relatively small firms engaged in "stripper" operations, since the profitability of such operations, it is alleged, depends to a large extent on favorable tax treatment. Curtailing these operations would result in a considerable waste of recoverable mineral resources. On the other hand, large vertically integrated firms would be in a relatively stronger position, since they would be able to draw on their resources from processing and marketing operations, as well as having readier access to capital markets.

Finally, proponents of the present system maintain that it has become capitalized in the financial structure of the Nation's extractive industries. It is argued, therefore, that any drastic revision of the present law would occasion significant changes in financial structure and policy, which almost certainly could not be accomplished in an orderly manner. Such changes, moreover, would probably result in the elimination of a substantial number of independent producers and significant capital losses for shareholders in all oil-producing companies. The revenue gains to the Government from elimination of so-called excess depletion allowances, accordingly, would be more than offset by virtue of capital-loss offsets and in the long run by a shrinking of the tax base.

B. OPPOSITION TO THE PRESENT PROVISIONS

Critics of the present tax provisions in the natural resource area urge revision of the law on the basis of equity, revenue, and economic considerations.

1. Equity issue

It is maintained that there is no theoretical justification for treating mineral producers differently from other taxpayers through a system of percentage depletion allowances or through privileges of expensing exploration and development costs. For other expenditures for fixed capital, it is pointed out, the tax law limits total deductions for capital recovery to the amount actually invested by the taxpayer and, except in the case of accelerated amortization and research and development costs requires that these deductions be spread over the useful life of the property. In the extractive industries, on the other hand, the taxpayer is allowed to recover tax free virtually the full amount of his investment in a mineral property often in the year the outlays are made and subsequently claim percentage depletion allowances which bear no relationship to the amount of his investment. Accordingly, the law may permit tax-free recovery of his capital costs several times over. In fact, it is contended, from the standpoint of accounting or economics, it is questionable whether these special deductions should properly be called depletion, since they do not relate to any capital sum that is being exhausted.

The effect of these provisions in a number of selected cases was presented by the Secretary of the Treasury in a statement before the Committee on Ways and Means of the House of Representatives on February 3, 1950. The Secretary presented data for 10 individuals whose net income over the 5 years 1943–47 aggregated $61.9 million. "Net income" was defined in this statement as income after all deductions for ordinary costs, including operating expense, depreciation, cost depletion, exploration costs, and losses on abandonments, but without allowance of deductions for percentage depletion in excess of cost bases or for the expensing of development costs. For Federal tax purposes, however, these latter special deductions were also allowed, resulting in Federal income-tax liabilities which totaled only $13.9 million, representing an overall effective rate of 22.5 percent of net income. In the most extreme case, the taxpayer paid Federal income taxes of only $80,000 on a 5-year income of $14.3 million, an effective rate of only 0.6 percent. In 3 other cases, effective tax rates were less than 10 percent, and in only 1 case was the effective rate over 50 percent, on a net income which averaged nearly $2 million a year.

The Secretary's data showed, moreover, that of the total $61.9 million of net income, $20.9 million, or 33.8 percent, was offset by deductions for percentage depletion and $26.7 million, or 43.1 percent, was offset by development cost deductions. In several cases, these deductions combined exceeded total net income for the individuals over the 5-year period. In addition, in 4 of the 10 cases, deductions for depletion and development costs exceeded net income derived from mineral properties, the excess serving to reduce the amount of income from other sources subject to tax.

The distinction between these two types of deductions, it is alleged, is important in appraising the present tax provisions for natural resources. Percentage depletion in excess of cost depletion represents, in effect, an exemption of certain amounts of income irrespective of the use to which it is put. Expensing deductions are available, however, only where current income is immediately invested in further oil development. Those individuals in this group with the least tax liability were currently investing large amounts of income in oil production. Critics of these allowances contend that while this investment may be socially desirable, it is questionable whether investment in oil has sufficient social priority over other investment to warrant this preferential treatment.

The Secretary also presented data with respect to 20 selected mineral corporations for the year 1947. These showed that on a total net income[19] of $926.6 million, Federal corporation income liabilities amount to only $179 million, an effective rate of 19.3 percent. Since the statutory tax rate in 1947 was 38 percent for corporations in this income range, percentage depletion and development cost deductions were equivalent to almost a 50-percent rate reduction.

In view of these substantial tax benefits, it is argued, particularly cogent reasons have to be provided for continuation of the present preferential treatment. The argument that percentage depletion closely approximates adjusted basis depletion based on fair market value of the property is held to be without substance, since capital allowances elsewhere in the law are not based on current market valuations but on the amount actually invested by the taxpayer. Generalization of this argument, it is maintained, would mean exemption of all capital gains from tax, and consistency would require the upward adjustment of deductions for depreciation, inventories, and other cost items, whenever the current value of an asset exceeded its original cost. On the contrary, it is maintained that the excess of the value of a developed property over its cost to the taxpayer actually represents income in the form of a capital gain, the tax on which is deferred until realization. No occasion, therefore, exists for deduction of any amount in excess of the taxpayer's investment. Accordingly, it is maintained that in view of the invalidity of the conceptual argument offered by proponents of the present arrangement, this major leakage in the Federal income-tax base should be eliminated.

2. Revenue considerations

The revenue effect of percentage depletion and development cost allowances is cited as a major reason for revising the law in this area. The Paley Commission estimated the revenue loss attributable to excess depletion claimed by individuals and corporations in 1948 was about $530 million.[20] Taking into account increases in tax rates, output and prices of mineral products, the extension of percentage depletion to additional minerals, and the increase in depletion rates since 1948, the present loss may well be in excess of $1 billion on corporate returns alone. Adding to this amount the revenue cost of these allowances claimed by individuals may bring the present total to around $1.2 billion.

3. Economic considerations

Many critics of the present tax provisions pertaining to natural resources maintain that the need for these provisions as incentive devices has been overstated. Moreover, they hold that the overall impact of these provisions is little understood and that, therefore, a basic reappraisal of tax policy in this area is required.

[19] Computed as net income for tax purposes plus depletion in excess of adjusted basis depletion and development costs.

[20] Resources for Freedom, vol. V, a report to the President by the President's Materials Policy Commission, 1952, p. 14.

In the first place, it is pointed out that in a fully employed economy, efforts to increase the level of activity in any one industrial area must necessarily be at the expense of output in other sectors of the economy, at least in the short-run. Tax policy to afford special privileges with respect to particular types of business activity, therefore, should be based not only on consideration of the absolute demand of the economy for the output of the affected industry but also upon careful and explicit consideration of relative priorities. With "neutral" tax treatment for the extractive industries, the relative priority of mineral output would be expressed through the market mechanism in the price of such output as compared to that of other industries. Thus, if users of mineral products anticipated an increased demand, this would be reflected in a relative increase in the prices of the affected minerals which would serve to attract additional resources to these industries and away from those for which anticipated demand was either falling, remaining stable, or increasing at a lesser rate. With preferential tax treatment only indirectly related to the pricing process, however, economic priorities in mineral industries are not accurately measurable. As a corollary, the real costs of these tax incentives, in terms of the loss of the alternative products of the extra resources in extractive industries, has not been determined.

Secondly, it is pointed out that one of the principal reasons offered for preferential tax treatment in the extractive industries is the relatively great risk associated with exploratory and developmental ventures. Such risks are particularly burdensome for the small, independent operator. Indeed, it was to offer encouragement to the small prospector that special depletion allowances were first introduced. The most recent data available from Statistics of Income, however, show that almost 63 percent of the $2.1 billion total depletion allowances claimed by corporations in 1951 were on returns of companies with assets of $100 million or more while 84 percent of the total was claimed by corporations with assets over $10 million and 96 percent was accounted for by companies with at least $1 million in total assets.[21] Companies of this size are in a position to protect themselves from overall losses and in effect insure against the extraordinary risks of prospecting and developing of particular mineral properties through broad diversification of efforts. Accordingly, it is maintained that the distribution of the incentives of special depletion allowances is quite different from that conceived in the original provision.

Some critics also point out that there are severe risks to investments in other types of industrial activity. They question whether capital invested in the development of electronics, atomic energy, automobiles, etc., is not equally at risk. In the capital markets, they point out, the major mineral resource companies are not given poorer investment ratings than many other types of enterprise whose products are also of national interest.

Moreover, it is argued that the appropriate treatment for any extraordinary risk in prospecting for and developing mineral resources lies in assuring adequate offsets for losses which may be sustained. In the case of large firms, self-insurance against these risks is provided through the reduction in tax liability resulting from offsetting these losses either against the income from established mineral properties or

[21] Statistics of Income, pt. II, 1951, pp. 118–119.

against the income derived in other lines of activity. It is the small prospector, therefore, with inadequate income from existing properties or other sources for whom special treatment should be provided in order to provide the required incentives. Since percentage depletion allowances depend on net income from the property, they offer the small operator little or no protection against risk in the exploratory and development stages. Instead, the tax benefits are obtained only after the property reaches production on an established basis.

Finally, it is argued that the incentives afforded by the special tax treatment fall in a haphazard way even among mineral producers and contribute very little to an orderly process of natural resource development. In fact, it is argued, these provisions actually tend to induce wasteful and uneconomical practices. For example, the net cost to an individual in the top income bracket of exploratory and development activity is only 9 cents on a dollar, since these costs may be deducted currently against his income from other sources. In view of this relatively low cost, inadequate care and selectivity may be exercised in committing resources to this type of activity. In addition, the substantial reduction in effective tax rates on income from mineral output, resulting from percentage depletion allowances, constitutes a strong inducement for wasteful rates of production, contrary to sound conservation practices.

III. Proposals for Tax Revisions

A wide variety of proposals have been offered for revision of the tax treatment of income derived from mineral properties. In most cases these proposals have sought to mitigate the tax avoidance opportunities in the present law while retaining certain incentive features.

The most extreme proposal calls for the complete elimination of percentage depletion and the limitation of deductions for capital recovery to the adjusted basis of the property. Alternative methods to accomplish this result have been suggested:

1. Reduce the remaining recoverable basis of a mineral property by all depletion, including percentage depletion, previously deducted. This treatment would conform with the provisions for determining the adjusted basis for computing gain or loss on the sale or exchange of the property. In some cases, this treatment would, in effect, recoup for the Government the tax advantages of past excess depletion since future cost depletion deductions would thereby be reduced. In this sense, the method might be open to the objection that it retroactively took away the percentage depletion of prior years.
2. Limit the remaining recoverable basis to the original basis reduced only by allowable cost depletion to date. This would result in larger cost depletion allowances in the future as compared with the first method.
3. Limit the remaining recoverable basis to the original basis not reduced by any previous depletion allowed or allowable. This provision would permit the continuation of some excess depletion allowances on existing mineral properties although limiting total depletion on future properties to original costs.
4. Require the capitalization of the investment costs of a mineral property, but permit the taxpayer to write off the adjusted basis of a

property through cost depletion on an accelerated basis, e. g., over 3 or 5 years. This method would provide capital recovery allowances similar to those available on defense facilities certified for 5-year amortization.

5. Limit total allowances to the adjusted basis of the mineral property but permit the taxpayer to claim these allowances at any rate he selects. This would in effect permit expensing of capital costs, though limiting deductions to the amount actually invested by the taxpayer.

A somewhat less extreme proposal would permit the taxpayer to claim percentage depletion allowances but would limit the total of such allowances to the adjusted basis of the property. Under this proposal, percentage depletion allowances would represent an alternative available to each taxpayer to expensing of the capital costs incurred in exploration and development, since current deductions for such costs would reduce the adjusted basis of the property. A more liberal variation of this proposal would permit both expensing of capital costs and percentage depletion, limited in the aggregate to the original cost of the property. In effect, this would permit the taxpayer to write off up to twice the amount of his actual investment in the mineral property.

It has also been suggested that a 3-year income tax exemption be substituted for the present percentage depletion on new mineral deposits. Taxpayers would be permitted to expense exploratory and development costs, as under the present law, and would be exempt from tax on the first 3 years' income from the mineral property. Thereafter, however, no capital recovery allowances of any sort would be permitted.

Perhaps the least drastic revision suggested in this area would make no fundamental change in the present provisions but would reduce percentage depletion rates on most mineral properties. Reduction of the rate on oil and gas and on metals produced in the United States to 15 percent has been urged. While this proposal would not eliminate the objection that percentage depletion permits multiple tax-free recovery of investment, it would significantly reduce the current revenue loss. It has also been suggested that the net-income limitation be reduced from the present 50 percent to, say, 25 percent or 30 percent. This revision would bear least heavily on properties with a high ratio of net income to gross income. In the case of many oil royalties, net income commonly is equal to gross income. In such cases the net-income limitation would not serve to reduce percentage depletion allowable unless the limitation were less than 27.5 percent of net income.

The contrary proposal has also been offered. It is pointed out that the net-income limitation serves to curtail percentage depletion allowances for mineral producers with relatively low ratios of net income to gross income. It is asserted, for example, that a large proportion of the operators in the bituminous-coal industry are unable to use the full allowance of 10 percent of gross income because they operate on a very narrow profit margin and are subject to the net-income limit. Such firms, it is claimed, need at least as much preferential treatment as is afforded the more profitable operations. Those who defend the net-income limitation, however, point out that operators with persistent losses or very small profit margins would derive little benefit from its elimination while the principal benefits would accrue to more successful operations.

Finally, it has been proposed that all elements of preferential tax treatment in the natural resource area be eliminated in favor of relying on nontax incentives for mineral resource development. Direct subsidies, stockpiling of strategic materials, price supports, extension of development loans or bonuses, and similar arrangements have been suggested as more effective devices for directing incentives to those lines of activity where they are most needed. In addition, it is maintained that such programs would reveal the real cost of these incentives to public scrutiny through the regular executive and congressional budget processes, in contrast with the tax benefits which in character and scope receive little public attention.

DEPRECIATION

I. Present Law

Business expenditures in plant, machinery and equipment and other capital assets cannot ordinarily be deducted in full in computing taxable income for the year in which the expenditure is made. Rather the expenditure must usually be apportioned over the estimated useful life of the asset and each year's operations charged with its proportion of the total cost until the full amount is deducted. Depreciation allowances are limited to property used in a trade or business or otherwise held for the production of income.

A. METHODS OF COMPUTING DEPRECIATION ALLOWANCES

The present law [1] sets out three methods of computing depreciation (including a reasonable allowance for obsolescence) as follows:

1. The straight-line method.
2. The declining-balance method at not exceeding twice the straight-line rates.
3. The sum of the years-digits method.

The law also allows any other consistent method, provided the deductions at the end of each year during the first two-thirds of the useful life of the property do not result in accumulated allowances greater than those allowed by the declining-balance method.

Straight-line depreciation allowances are computed by applying the depreciation rate (equal to the estimated useful life of the property divided into (1)) to the cost of the asset less its salvage value. As indicated by the name of this method, the amount of the allowance is the same each year over the asset's useful life.

Under the declining-balance method, a uniform rate (which may be as much as twice the straight-line rate) is applied to the unrecovered basis of the asset. Since the basis is always reduced by prior depreciation, the rate is applied to a continually declining basis.

Under the sum of the years-digits method, the annual allowance is computed by applying a changing fraction to the taxpayer's cost of the property reduced by estimated salvage value. The denominator of the fraction is the sum of the numbers representing the successive years in the estimated life of the asset and the numerator is the number of years, including the current year, remaining in the useful life of the property. In the case of a 5-year property, for example, the allowance in the first year is computed by applying to the depreciable value of the asset the fraction $\frac{5}{15}\left\{\frac{5}{1+2+3+4+5}\right\}$. In the second year, the allowance would be $\frac{4}{15}$ of the original cost of the asset, less salvage.

[1] I. R. C., sec. 167.

The straight-line method is available to all types of depreciable property whether acquired new or secondhand, and no matter when or how acquired. The declining-balance method at not more than twice the straight-line rates and the sum of the years-digits method are available only with respect to assets with a useful life of 3 years or more and constructed after December 31, 1953; neither method is available for used or secondhand property. A taxpayer has the option to switch to the straight-line method from another method, on the basis of unrecovered cost (less estimated salvage) and remaining life at the time of the switch.

The operation of each of these methods is shown in the following table, assuming an asset costing $10,000 with an estimated useful life of 10 years and insignificant salvage value.

Year	Straight line		200 percent declining balance		Sum of the years-digits	
	Annual charge	Cumulative charges	Annual charge	Cumulative charges	Annual charge	Cumulative charges
1	$1,000	$1,000	$2,000	$2,000	$1,818	$1,818
2	1,000	2,000	1,600	3,600	1,636	3,454
3	1,000	3,000	1,280	4,880	1,455	4,909
4	1,000	4,000	1,024	5,904	1,273	6,182
5	1,000	5,000	819	6,723	1,091	7,273
6	1,000	6,000	655	7,378	909	8,182
7	1,000	7,000	[1] 655	8,033	727	8,909
8	1,000	8,000	655	8,688	545	9,454
9	1,000	9,000	655	9,343	364	9,818
10	1,000	10,000	655	9,998	182	10,000

[1] Switch to straight line for years 7 through 10. Cumulative charges do not add to $10,000 because of rounding.

As the table indicates, use of the declining-balance method at twice the straight-line rate results in the writeoff of about two-thirds of the cost of the asset over the first half of its life. The sum of the years-digits method permits recovery of almost three-fourths of the assets' cost over the same period. Under all three methods, full recovery of cost must be spread over the entire useful life of the asset.

Neither the law nor accompanying regulations specify the useful life to be used in computing depreciation allowances with respect to specific assets. The Internal Revenue Service publishes a bulletin (Bulletin F) which lists suggested useful lives for a very large variety of depreciable assets. These are offered as a guide to the taxpayer but are not binding upon him. The taxpayer and the Commissioner of Internal Revenue may enter into a written agreement as to the useful life and depreciation rate of a property. This agreement is binding and can be modified only upon proof, by the party instituting the modification, of facts or circumstances not taken into account in the original agreement.

B. SPECIAL DEPRECIATION ALLOWANCES

Special provision is made for emergency facilities certified by the Office of Defense Mobilization as necessary in the national defense.

Such facilities may be written off on a straight-line basis over a 5-year period, without reference to the customary useful life.[2] This

[2] I. R. C., sec. 168.

rapid writeoff is available only to that part of the total cost of such property which the ODM certifies as necessary and attributable to national defense. The President may terminate the grant of further certificates when the national-defense needs are satisfied.

Grain storage facilities constructed after December 31, 1952, and before January 1, 1957, may also be amortized over a 5-year period instead of being depreciated over their normal life.[3]

C. GAINS AND LOSSES FROM SALE OF DEPRECIABLE PROPERTY

Gains and losses arising from the sale or exchange of depreciable property held over 6 months are subject to special treatment.[4] Where the total gains from such sales or exchanges exceed the total losses (gains or losses measured as the difference between proceeds and adjusted basis), the net gains are treated as capital gains, subject to tax at a maximum rate of 25 percent. Where losses exceed gains, however, the net losses are treated as ordinary losses, fully deductible from income.

These rules do not apply in the case of emergency facilities on which amortization allowances have been made.[5] In such cases, that portion of the gain representing the excess of amortization allowances over regular depreciation allowances is taxable as ordinary income.

D. HISTORY OF CHANGES IN THE LAW

Prior to adoption of the Internal Revenue Code in 1954, there was no spelling out of methods of taking depreciation for income-tax purposes. The straight-line method was the method most frequently used, although other methods such as the unit-of-production method and the declining-balance method were permitted. In 1946, however, the Bureau limited the rates applicable to the declining-balance method to 150 percent of the straight-line rates. Subject to this limitation, the method was rarely used.

The history of depreciation policy for income-tax purposes may be divided into three periods: 1913 to 1933, 1934 to 1954, and since 1954. Before 1934, taxpayers could generally determine over what period and at what rate they should write off their assets. These deductions were permitted to stand unless the Bureau of Internal Revenue could show by clear and convincing evidence that they were unreasonable.

In 1933, a subcommittee of the Committee on Ways and Means recommended, as a means of increasing tax revenues, that for the next 3 years depreciation allowances should be reduced by one-fourth. The Treasury suggested as an alternative that it be permitted to tighten up its practices in a way which might prove more equitable than a flat reduction for everybody. This was agreed to, and the Treasury adopted Treasury Decision 4422 which paved the way for redetermining the period over which assets should be written off, and shifted to the taxpayer the burden of proof as to correctness of deductions. The Bureau subsequently issued Bulletin F containing estimates of the useful lives of many classes of property.

From 1934 to 1954, the Treasury and congressional attitudes on depreciation allowances were under constant attack by industry.

[3] I. R. C., sec. 169.
[4] Sec. 1231.
[5] Sec. 1238.

Depreciation problems constituted a major source of conflict and occasioned many controversies between taxpayers and the Bureau of Internal Revenue. The basic problem generally at issue was the alleged too long estimated useful life placed on assets by the Bureau, with the result, charged by taxpayers, that they lacked an opportunity to recover their investments with sufficient promptness. The policy was frequently referred to as presenting a deterrent to investment.

The only important legislative departures from this strict policy were the adoption in 1940 and 1950 of provisions for accelerated amortization of defense facilities during World War II and the Korean war and thereafter.

The adoption of the Internal Revenue Code of 1954 specifically authorized the use of the more liberal 200 percent declining balance and sum of the years-digits methods of depreciation. It did not, however, involve any changes with respect to the useful lives over which assets might be written off, nor any change in the historic cost basis for depreciation allowances.

E. FOREIGN

Depreciation allowances in other countries follow no fixed pattern. The usual methods available in the United States are available in most other countries, with emphasis generally on the declining balance method. Many countries throughout the world have been faced with inflation in a much more serious way than the United States. Some have provided for a reappraisal of capital assets, basing depreciation on the reappraised value. Others provide each year for setting a coefficient usually bearing some relation to changes in the purchasing value of the currency; this coefficient is used to revise depreciation computed on the original cost basis. Many countries have adopted special depreciation devices to stimulate investment.

1. Canada

Depreciation in Canada is computed very largely according to the declining balance method. This was adopted in 1949 with rates approximately twice the theretofore prevailing straight-line rates. During wartime Canada has allowed double depreciation to stimulate investments in assets which would have little peacetime value. At other times allowances have been deferred on new construction as a measure to discourage capital investment.

2. Germany

In addition to normal depreciation, basic industries (coal mining, steel, power, and water supply industries) enjoy special depreciation allowances for business assets acquired after January 1, 1952. These special allowances amount to 50 percent of the cost of movable property and 30 percent of the cost of fixed business assets. They may be taken during the year of acquisition of the asset and the 2 years following.

3. Great Britain

Investment allowances were provided in Great Britain in 1954 to replace (with a few exceptions) the so-called initial depreciation allowances which had been in effect in 1945–54 (except the year 1952–53).

The purpose of both was to encourage the modernization and reequipment of British industry. The new allowance, which is in addition to depreciation (and therefore allows recovery in excess of investment), is as follows:

20 percent for expenditure on new plant and machinery, scientific research, and mining works;

10 percent for new industrial and agricultural buildings.

The generally replaced initial allowances will continue, however, for motor cars and secondhand plant or machinery. Thus an investment in secondhand machinery will receive a 20 percent initial allowance, but depreciation will be allowed only to the extent of the balance.

4. Sweden

Much attention has in the past been given to the liberal depreciation laws in Sweden. Beginning in 1938, Swedish tax laws allowed limited liability companies and cooperative associations (but not unincorporated firms) to charge off a purchase of machinery as a cost wholly in the year of purchase. In practice, most firms spread the depreciation over a longer period, but the system did allow them to charge more in years of good profits and less or none in other years. The system did not apply to industrial buildings for which depreciation allowances were restricted on an average to 3 percent a year.

A committee on business taxation, reporting to the Government in August 1954, found as valid certain criticisms made of the practice. It was found that freedom with respect to depreciation tempted business enterprises to make large capital expenditures in order to be able to increase writeoffs, and thus reduce taxable profits. This tended to increase demand for capital goods in boom periods and aggravate the inflationary situation. Further, the possibilities of self-financing based on excessive writeoffs made business less sensitive to measures of credit restraint.

The committee proposed that the system of "free depreciation" be abolished and that depreciation allowances should be limited to 30 percent a year on the book value of machinery and equipment for the first 2 years, and thereafter straight-line depreciation should be taken at the rate of 20 percent. Legislation was adopted to give effect to these recommendations and also to extend the provisions to private firms and partnerships.[6]

II. Issues in Depreciation Policy

The major current issue in the tax treatment of depreciation concerns the so-called "accelerated depreciation" provisions of the 1954 Internal Revenue Code. In addition, controversy continues over the appropriate capital sum to be written off through depreciation charges, i. e., original cost or replacement cost. In recent months the desirability of continuing special amortization charges for defense facilities has been the subject of public inquiry. Finally, a long-standing issue has been the appropriateness of Bulletin F useful lives as guides for determining depreciation rates.

[6] Based on Index (Svenska Handelsbanken's Monthly Economic Review), March 1955, pp. 1–2; May 1955, p. 4.

A. ACCELERATED DEPRECIATION IN THE 1954 CODE

Proposals for the statutory revision of depreciation allowances which were incorporated in the Revenue Act of 1954 were based on two principal arguments: (1) The (then) existing straightline depreciation was "unrealistic," i. e., did not adequately measure true depreciation, especially in the early years of an asset's life; and (2) more liberal depreciation allowances would reduce deterrents to plant and equipment expenditures and stimulate capital outlays. The President in his budget message of January 21, 1954, in urging revision of depreciation allowances as an important part of his program of tax reform, stated these arguments as follows:

> A liberalization of the tax treatment of depreciation would have far-reaching effects on all business and be especially helpful in the expansion of small business whether conducted as individual proprietorships, partnerships, or corporations. At present, buildings, equipment, and machinery are usually written off uniformly over their estimated useful lives.
>
> The deductions allowed, especially in the early years, are often below the actual depreciation. This discourages long-range investment on which the risks cannot be clearly foreseen. It discourages the early replacement of old equipment with new and improved equipment. And it makes it more difficult to secure financing for capital investment, particularly for small business organizations.

These arguments were offered repeatedly during the legislative development of the 1954 Revenue Code.

1. *Measurement of true depreciation*

The inadequacy of straight-line depreciation in accurately measuring true depreciation has long been maintained. It is contended that in general the value of a piece of equipment or machinery decreases at a decreasing rate, the loss in value being most pronounced in the early years of the asset's life. Automotive equipment is cited as a prime illustration of this problem. Accordingly, it is argued, depreciation charges for tax purposes should be permitted to reflect this pattern, which is closely approximated both by the declining balance method, using a rate twice the straight-line rate, and by the sum of the years-digits method. Failure to permit tax deductions according to this pattern, it is maintained, involves a forced loan of tax funds from the taxpayer which he can recoup only in the later years of the asset's life. Considering the total amount of assets acquired in recent years, these forced loans amount to a very considerable sum. Moreover, the resulting misstatement of income has adverse effects on management considerations with respect to replacement policies.

In answer to this argument, critics of the 1954 depreciation provisions maintain that no single pattern of depreciation can be safely generalized for all types of depreciable property. While it may well be true that automobiles frequently exhaust a disproportionate amount of their serviceability in their first year or two, this is a result primarily of changes in demand resulting from style changes and from technological innovation. It does not follow, however, that the same pattern of value loss is applicable, say, to an electric-power generating facility, which has a substantially longer useful life and which is not subject to the changes in market condition which affect automobile values.

Moreover, it is contended that according to traditional accounting concepts, depreciation is a device for measuring the annual conversion of the prepaid expense represented by the asset into cost as the asset is exhausted over its service life. Since with reasonable maintenance and repair expenditures, the exhaustion of serviceability generally accelerates in the later years of an asset's use, the most appropriate measure of true depreciation would be afforded by a method under which depreciation allowances would increase in each successive year.

Finally, it is argued that the straight-line method in fact reflects a more rapid conversion of asset into cost in the asset's early years than in its later years. This is true, it is pointed out, since at any rate of discounting future receipts greater than zero, the present or commuted value of any depreciation charge decreases the further it is in the future. In these terms, therefore, the depreciation method which assumes the equal contribution to income in each year popularly ascribed to straight-line depreciation is, in fact, the annuity method, which provides for an increase in deductions at a compound interest rate.

2. Depreciation policy to stimulate capital outlays

Proponents of the liberalized depreciation provision of the 1954 Revenue Code contend that the adoption of these provisions will make a significant contribution toward increasing the level of investment in depreciable property. In the first place, it is pointed out, even though the total depreciation which may be charged with respect to an asset is unaffected by the changes, the fact that a larger proportion of those charges may be made sooner serves to increase the present value of the total amount of allowances. This, in turn, means that the present value of the after-tax returns on the asset are greater than under straight-line depreciation, even though the absolute amount of charges over the life of the asset are the same. This increase in profitability serves to stimulate demand for depreciable property.

This effect, it is argued, is most pronounced in the case of long-lived property. Such property includes basic steel and other metal capacity, refineries, public-utility installations, and other facilities which represent the basic source of the economy's growth. The stimulus to capital outlays provided by accelerated depreciation, therefore, is regarded as particularly desirable in an economy in which growth is so essential.

Secondly, it is maintained that the new depreciation provisions will contribute to increasing investment through their effect on the risk involved in such investments. Particularly in the case of long-lived assets, it is argued, the difficulty in foreseeing the usefulness of the property over a substantial portion of its life results in management setting a relatively brief period over which the asset must pay for itself. The greater the portion of the asset's cost which may be recouped through depreciation allowances within this "payoff period," the less is the risk incurred in the asset's acquisition. Use of the 200 percent declining balance and sum of the years-digits methods, which return approximately two-thirds and three-fourths, respectively, of the asset's cost in the first half of its life, therefore, should contribute materially to reducing the risk deterrents to plant and equipment expenditures.

Finally, it is maintained that the new depreciation provisions will help substantially in reducing the working capital barriers to acquisition of fixed assets. This difficulty is regarded as particularly acute in the case of small and new businesses, whose internal funds are frequently inadequate to finance capital programs and who have access to credit only on relatively unfavorable terms. Accelerated depreciation will assist such companies both by permitting smaller cash outflows for taxes in the early years after acquisition of depreciable property and by, in effect, facilitating the repayment of any loan which may be required to finance these acquisitions.

Critics of the accelerated depreciation provisions maintain that the merits attributed to them in stimulating investment are greatly exaggerated. In the first place, it is pointed out that over a wide range of useful lives and discount rates, the present value of the tax savings in the early years of an asset's life under the accelerated as compared with straight-line depreciation is a relatively modest amount. One estimate is that on the average, the incentive effect of acceleration is equivalent, at present tax rates, to about a 5-percent reduction in the cost of the asset. This is regarded as insufficient to loom large in managerial considerations with respect to investment programs, except in marginal cases.

Secondly, it is contended that the effectiveness of accelerated depreciation allowances in offsetting risk is overstated. If risk is measured by the rate at which the taxpayer discounts future receipts, it will be found that as the discount rate rises, the benefits from acceleration do indeed increase, but only up to a point. Beyond this point, i. e., at very high rates of discount reflecting very risky investments, the benefits from acceleration fall off markedly. Moreover, the benefits are often greater in absolute amounts (though not in relative terms) for short-lived assets than for long-term properties. Since it is the latter to which the greater risk is attributed, accelerated depreciation may actually operate perversely in encouraging relatively greater investment in relatively safe assets.

In addition, it is pointed out that the effectiveness of accelerated depreciation in improving the working-capital position of taxpayers depends on their having adequate income to absorb the increased depreciation charges in the early years of an asset's life. While this may present little difficulty in the case of large, established firms, it is argued that the situation is not so certain in the case of small or new companies. The latter, particularly, may derive little benefit from acceleration since very often the profits in early years of operation are quite meager.

It is further pointed out by critics of the new depreciation provisions that the limited incentives afforded are at the expense of a substantial revenue loss to the Federal Government. One estimate of this loss, assuming constant levels of plant and equipment outlays, shows the loss rising from about $375 million in fiscal 1955 to $2.2 billion in fiscal 1960, following which it will fall until 1969 when a $325 million gain in revenue will be realized.[7] If an increasing rate of capital outlays, apart from any increase stimulated by the new depreciation provision, were projected, the revenue loss would be considerably in excess of these amounts and would not decline absolutely so long as outlays increased. Thus, it is pointed out that while the revenue loss may be only temporary with respect to any given item of depreciable property, in the aggregate the new depreciation provisions provide indefinite postponement of substantial amounts of revenue.

[7] Estimate by the staff of the Joint Committee on Internal Revenue Taxation, 83d Cong., 2d sess., H. R. 1337, report of the Committee on Ways and Means to accompany H. R. 8300, Internal Revenue Code of 1954, p. B-13.

Considering the magnitude of these losses, critics of the accelerated depreciation provisions maintain that a more substantial incentive to capital outlays could be provided through other devices. It is argued, for example, that general tax reductions of these magnitudes probably would more effectively induce the desired increase in capital outlays. Alternatively, special incentive provisions, similar to the investment allowance provided in the United Kingdom, are suggested.

Finally, it is argued that the accelerated depreciation provisions may well serve to accentuate fluctuations in levels of economic activity and impose a greater burden on other fiscal and monetary stabilization devices. The new provisions, it is maintained, will have little effect on plant and equipment outlays during a business downturn but may be counted on to provide some stimulus for such expenditures when boom conditions develop, i. e., at the very time when a dampening of total spending is required to prevent inflation.

B. CAPITAL COST RECOVERABLE THROUGH DEPRECIATION

Under the present law, total depreciation deductions over the life of a property may not exceed its original cost less estimated salvage value.[8] This historic cost or adjusted basis limitation on depreciation allowances reflects the traditional accounting concept which regards the cost of a fixed asset as a prepaid expense. This prepaid expense is gradually converted into cost as the property is exhausted over its service life. Since, under this view, the purpose of depreciation charges is to measure the annual conversion of asset into cost in order to determine the net profit from the asset's use, total depreciation charges cannot exceed the original cost (or adjusted basis) to the taxpayer.

The historic cost limitation on recoverable capital value is frequently criticized as producing an inaccurate measure of taxable income in an economy characterized by fluctuations in asset prices. This criticism is based on the concept of depreciation as a measure of the loss in the capital value of plant and equipment sustained over the course of the accounting period, regardless of the factors responsible for this value loss. In order accurately to determine taxable income, it is claimed, it is necessary to adjust depreciation allowances to reflect changes in asset values over the income period. The purpose of depreciation allowances under this concept is to provide an adequate fund out of current income for the replacement of the fixed capital employed in the production of that income. Where prices are rising over the course of an asset's life, it is argued, limiting depreciation allowances to historic cost will result in an inadequate tax-free reserve for replacement of the asset. The income tax, therefore, will have taxed away some portion of the capital invested as well as the income produced by the investment.

Numerous objections have been raised against proposals for substituting replacement cost for historic cost as the basis for limiting cumulative depreciation charges. Chief among these is that the contention that historic cost depreciation results in an inadequate replacement fund is valid only under certain unlikely assumptions. In the general case of an expanding company, it is argued, cumulative depre-

[8] Exceptions to this rule are made in the case of property acquired before March 1, 1913, or acquired by gift or transfer in trust, upon an exchange, upon an involuntary conversion, or by transfer at death.

ciation charges will more than adequately meet replacement needs unless replacements are made according to a grossly discontinuous pattern[9] or unless asset prices increase at a greater rate than the rate of increase, in real terms, of total facilities.

A second objection raised is that consistency would require the use of a concept similar to that underlying replacement cost depreciation in measuring taxable income from all sources, not merely from depreciable facilities. Thus, changes in price levels would have to be taken into account in measuring gains and losses on capital assets. Similarly, if property income were to be measured in "real" terms for tax purposes, a similar measurement would have to be employed for wages and salaries. The practical difficulties in such an approach to income taxation would, of course, be formidable. Yet, in the absence of a general system of real income measurement, special provisions to this effect for a limited number of income categories would probably produce undesirable shifts in tax-burden distribution during periods of general price movements.

A final objection is that replacement cost depreciation would operate counter to the stabilization devices in the revenue system. Thus, in a period of falling prices, characterizing a business downturn, depreciation allowances would be cut back at the very time when stabilization policy would call for an increase in internal funds for business. By the same token, when boom conditions resulted in rising prices, depreciation allowances would increase, and tax liabilities would fall just when increased tax revenues were required.

C. SPECIAL AMORTIZATION ALLOWANCES

Criticism has recently been directed against continuing the 5-year accelerated amortization of certified defense facilities. Since 1950, over $30 billion worth of industrial expansion has been certified for this fast writeoff. The Secretary of the Treasury, appearing before the Subcommittee on Legal and Monetary Affairs, House Government Operations Committee, on July 18, 1955, advocated substantial curbing of the amortization program. He stated that the "crash" defense program has been substantially completed, and continuation of emergency amortization (as of July 1955) constituted an artificial stimulus of a dangerous type. He urged that our basic defense capacity cannot be separated from the broad base of productive capacity, and to extend emergency amortization to some and not to others could hinder the sound, balanced, and vigorous growth of our whole free economy. The Secretary also pointed out that the estimated loss from the program during the fiscal year 1956 would be $800 million, and any extension of the program could well stand in the way of future general tax reduction.

Subsequently, pending further study, the Office of Defense Mobilization shut down completely the granting of certificates in 19 industries and suspended action on applications in 38 other industries. The order did not affect 20 industries having a direct defense relationship.

Those advocating continuance of emergency amortization argue that its termination would greatly intensify the problem of financing new construction, thereby checking needed expansion of basic defense

[9] To take an extreme example, if a company acquiring one 20-year asset per year for 20 years replaced all 20 of the assets in the 20th year.

capacity. Moreover, it is contended that alternative means of inducing the acquisition of this defense capacity, such as price premiums in Government contracts, would be equally costly and might seriously disrupt price stability.

D. BULLETIN F USEFUL LIVES

One of the principal sources of complaint against administrative practice with respect to depreciation allowances concerns the useful lives offered as guides to the taxpayers by the Internal Revenue Service in its Bulletin F. Although these are not binding upon the taxpayer, it is alleged that they have, in effect, the force of regulation. Accordingly, the taxpayer encounters considerable difficulty in establishing a useful life for his property other than that indicated in the bulletin.

Bulletin F lives are determined on the basis of average experience in the industries in which the respective assets are concentrated. They are intended to take into account such factors as the physical conditions of use as they affect physical wear and tear, repair and maintenance policies, technological obsolescence, and changes in market conditions. Critics of the present practice contend that since Bulletin F lives are historical averages, they cannot always be regarded as appropriate. Accordingly, a number of proposals have been made to mitigate the alleged restrictive effect of the bulletin.

The most extreme proposal would allow the taxpayer to use whatever useful life and therefore whatever depreciation rate he considered applicable with respect to a property or group of properties so long as the resulting depreciation was charged for book purposes as well as tax purposes. This "optional" depreciation, it is claimed, would place these determinations within the purview of basic business considerations instead of tax considerations. Pressure from stockholders and from the securities' market, it is contended, would prevent abuse through use of excessively short writeoff periods. On the other hand, it is argued that this proposal would have adverse consequences for economic stability and would result in a substantial shift of tax burdens to taxpayers deriving income from sources other than depreciable facilities.

It has also been proposed that frequent revisions of Bulletin F should be made in order to assure the most up-to-date estimates of useful lives. In particular it is suggested that downward revisions of Bulletin F lives should be made as soon as possible.

Another proposal would permit the taxpayer a, say, 10-percent latitude in the use of Bulletin F lives. For example, the taxpayer would be permitted to ascribe an 18-year life to a property identified in the Bulletin as a 20-year asset, without fear of contest by the Internal Revenue Service.

FEDERAL EXCISE TAXATION

I. Present Law[1]

The present system of Federal excise taxation provides for a variety of levies on a large number of selected products and activities according to widely differing rates. Some of the excises are imposed on manufacturers of the taxed commodities, some on retailers, some on occupations, and some on various services and facilities.

The table below outlines the major elements of the Federal system of excises.

Major Federal excises

Item	Present law rates
Alcoholic beverages:	
Distilled spirits	$10.50 per proof gallon.
Still wines	17 cents, 67 cents, $2.25 per wine gallon.
Sparkling wines, liqueurs, and cordials	$1.92, $2.40, $3.40 per wine gallon.
Beer	$9 per barrel.
Tobacco:	
Cigarettes	$4 per 1,000.
Cigars	$2.50 to $20 per 1,000.
Tobacco, chewing and smoking; and snuff	10 cents per pound.
Stamp taxes, documentary, etc.:	
Bond issues	11 cents per $100 face value or fraction.
Bond transfers	5 cents per $100 face value or fraction.
Stock issues:	
Par value	11 cents per $100 or fraction of par or face value.
No par value—actual value $100 or more per share.	11 cents per $100 or fraction.
No par value—actual value less than $100 per share.	3 cents each $20 or fraction.
Stock transfers:	
Par value—if selling price is under $20	5 cents per $100 or fraction of par or face value.
Par value—if selling price is over $20	6 cents per $100 or fraction of par or face value.
No par value—if selling price is under $20	5 cents per share.
No par value—if selling price is over $20	6 cents per share.
Deeds, real estate, conveyances, etc	55 cents on amount over $100 and not over $500; 55 cents on each additional $500 or fraction.
Foreign insurance policies:	
Life, sickness, accident, annuity contracts, and contracts of reinsurance.	1 cent per dollar or fraction of premium.
Other	4 cents per dollar or fraction of premium.
Playing cards	13 cents per pack of not more than 54.
Silver bullion sales or transfers of amount by which selling price exceeds cost plus allowed expenses.	50 percent.
Manufacturers' excise taxes (based generally on manufacturers' sales price):	
Airconditioners	10 percent.
Automobiles, etc.:	
Automobiles, passenger, auto trailers, and motorcycles.	10 percent.
Automobile trucks, trailers, buses, road tractors.	8 percent.
Parts and accessories	8 percent.
Tires	5 cents per pound.
Tubes	9 cents per pound.
Business machines (except retail cash registers)	10 percent.
Cameras, lenses and film	10 percent.
Cigarette, cigar, and pipe mechanical lighters	10 percent.
Diesel fuel for highway vehicles and special motor fuels.	2 cents per gallon.
Electric, gas, and oil appliances	5 percent.
Electric-light bulbs and tubes	10 percent.
Firearms, shells and cartridges	11 percent.
Fountain pens, mechanical pencils, ball-point pens.	10 percent.

[1] Subtitles D and E, I. R. C. 1954, secs. 4001–5862.

Major Federal excises—Continued

Item	Present law rates
Manufacturers' excise taxes—Continued	
Gasoline	2 cents per gallon.
Lubricating oil	6 cents per gallon.
Matches	2 cents per 1,000.
Musical instruments, phonographs and records, radio and television sets, and components.	10 percent.
Pistols and revolvers	10 percent.
Refrigerators, refrigerating apparatus, and quick-freeze units.	5 percent.
Sporting goods and equipment	10 percent.
Retailers' excise taxes (based on retailers' sales price):	
Furs and fur articles	10 percent.
Jewelry, etc.	10 percent.
Luggage, handbags, etc.	10 percent.
Toilet preparations	10 percent.
Miscellaneous excise taxes:	
Admissions (admissions not in excess of 50-cents exempt).	1 cent for each 10 cents or major fraction.
Bowling alleys, billard and pool tables	$20 per alley or table per year.
Cabarets, roof gardens, etc.	20 percent of taxable amount.
Club dues and initiation fees	20 percent of amount paid.
Coin-operated amusement or gaming devices:	
Amusement or music machines	$10 per machine per year.
Gaming devices	$250 per machine per year.
Leases of safe-deposit boxes	10 percent of amount collected.
Telephone, telegraph, radio, and cable facilities, etc.	10 percent of amount paid.
Transportation:	
Transportation of oil by pipeline	4½ percent of amount paid.
Transportation of persons	10 percent of amount paid (over 35 cents).
Transportation of property:	
Coal	4 cents per short ton.
All other	3 percent of amount paid.
Wagering:	
Wagers (except parimutuel)	10 percent of amount of wager.
Occupation of accepting taxable wagers	$50 per year.

To a substantial extent, the present Federal excise system has evolved in connection with the requirements of war finance. Some limited use was made of luxury excises during the War of Independence and in the War of 1812. Between 1818 and the outbreak of the Civil War, excises played no part in the Federal revenue system.

Tobacco and liquor excises, the two most important elements of the present excise system, were permanently established in the revenue system during the Civil War. In several years, these taxes produced more revenue than custom duties and were the principal source of internal revenue prior to the introduction of income taxes.

Extensive use was made of a wide range of excises during World War I. Most of these were repealed during the following decade, leaving tobacco, liquor, and stamp taxes as the major excises.[2] Most of the present manufacturer's excises were revived during the early 1930's, as a depression-tax measure in lieu of a general manufacturer's sales tax which was then proposed. This resulted in a significant increase in the revenue importance of excise taxation, particularly in view of the falling yield from income taxes. Excise revenues increased substantially through 1939 but declined in relative importance toward the end of the decade as individual and corporate income tax yields increased.

Under the impetus of World War II revenue requirements, the rates of most existing excises were substantially increased and the present retailers' excises were introduced, along with the taxes on transportation. While total excise collections increased very substantially

[2] Prior to the repeal of prohibition, of course, total liquor taxes were relatively unimportant revenuewise.

during the war, they nevertheless continued to decline in relative importance.

Extensive legislation to revise and reduce excises was underway in 1950 when hostilities in Korea broke out. Accordingly, the World War II excises were continued and indeed increased until the Excise Tax Reduction Act of 1954. The rate revisions under that act are shown in the following table. Further important reductions are scheduled to go into effect on April 1, 1956.

Changes in rates under excise tax reduction act of 1954

[Percent]

Taxable articles and services	Old rate	New rate
Sales, retailers:		
Luggage	20	10
Jewelry:		
Watches and alarm clocks selling for not more than $65 and $5, respectively	10	10
All other taxable articles	20	10
Furs	20	10
Toilet preparations	20	10
Sales, manufacturers:		
Sporting goods: All taxable articles other than fishing tackle	15	10
Cameras, lenses, and film	20	10
Electric light bulbs and tubes	20	10
Mechanical pencils, pens, and lighters	15	10
Refrigerators, quick-freeze units, and refrigerating and freezing apparatus	10	5
Electric, gas, and oil appliances	10	5
Pistols and revolvers	11	10
Admissions:		
Admissions generally (including season tickets and subscriptions)	(1)	(2)
Permanent use or lease of boxes and seats	20	10
Sales outside box office	20	10
Communications:		
Telephone toll service in excess of 24 cents	25	10
Telegraph, cable, and radio dispatches:		
Domestic	15	10
International	10	10
Leased wire services	25	10
Local telephone service	15	10
Transportation:		
Transportation of persons	15	10
Seats, berths, etc	15	10
Safe deposit boxes	20	10

1 1 cent for each 5 cents or major fraction thereof.
2 1 cent for each 10 cents or major fraction thereof (50-cent exemption).

Total excise collections in fiscal 1955 were $9.2 billion or about 13 percent of total tax collections. The relative importance of the major excises in 2 recent years is shown in the following table:

Excises	Fiscal 1954		Fiscal 1955	
	Amount (millions)	Percent of total	Amount (millions)	Percent of total
Liquor	$2,783	29.2	$2,726	29.6
Tobacco	1,580	16.6	1,571	17.1
Gasoline	837	8.8	947	10.3
Automobiles	867	9.1	1,048	11.4
Retailer's excises	438	4.6	292	3.2
General admissions	272	2.9	106	1.2
Communications	772	8.1	520	5.7
Transportation of property	396	4.2	398	4.3
All other	1,572	16.5	1,597	17.4
Total excises	9,517	100.0	9,201	100.0

Source: Treasury Bulletin, September 1955, pp. 48–49.

II. Issues and Proposals

A. ISSUES

The proper role of excises in the Federal revenue system has been the subject of continuing controversy, particularly since the end of World War II. This controversy has focused on the differential impact of excises on the various taxed industries, on the importance to be attached to the revenue yield of the present excise system, on its effectiveness in offsetting cyclical changes in income and on its impact on consumption and overall distribution of tax burdens. A wide variety of proposals, ranging from complete elimination of excise taxation to establishing a uniform manufacturers' or retailers' sales tax, have emerged from this discussion.

1. Impact of excises on business costs and prices

One of the principal arguments advanced against excise taxation, particularly in the form of a specific manufacturers' sales tax, is that this type of tax has an adverse impact on production and employment in the taxed industry. It is pointed out that excises imposed on the production of a taxed commodity enter the cost functions of the manufacturer in the same way as the costs of raw materials, labor services, and other factors of production, the outlays for which vary with output. Such increases in costs result in higher prices and tend to reduce sales and profits of the taxed producers. Accordingly, investment will tend to decrease in the taxed industry (or at least increase at a slower rate than in nontaxed industries), and to be diverted to nontaxed lines.

It is contended that these results may be justifiable under wartime or defense emergency circumstances, when as a matter of public policy it is desired to divert resources from uses making a relatively slight contribution to the defense effort. This type of tax is regarded as particularly appropriate where the resources used in producing the taxed items are readily transferable to defense production. For example, an excise on the production of lipstick, it is argued, will result in resources being freed for the production of cartridges. It is contended, however, that when the war or defense emergency is over, there is no basis for imposing a tax in such a form as to discourage production of specific commodities.

Moreover, it is contended that excise taxation has a highly differential impact even within a given industry. Some argue that a manufacturer's excise, for example, will be less burdensome on the highly integrated company in the taxed industry than on the nonintegrated firm. In the former case, the tax will enter the company's cost structure only once between production and sale to the ultimate consumer. In the latter case, however, the tax may very well be pyramided since the wholesale distributor will base his markup on his cost of the commodity including the excise and the retailer's markup will be based on his cost including the marked-up excise.

Others argue, however, that a manufacturer's excise bears more heavily on the integrated than on the nonintegrated company. The integrated company, it is claimed, incurs essentially the same costs of distribution as wholesale and retail distributors for nonintegrated firms. The manufacturer's excise is levied with respect to the manufacturer's sales price. Since for the integrated firms this sales price must reflect distribution as well as manufacturing costs, the tax will tend to be higher per unit of the taxed commodity in the integrated firm than in the case of the nonintegrated manufacturer, whose selling price does not include wholesale and retail distribution costs.

Similarly, the tax on transportation of property is regarded as bearing more heavily on some firms than on others in the same industry. Companies located close to the sources of raw materials of final product markets, it is pointed out, may have a substantial competitive advantage over those which are relatively distant.

Retailers' excises are regarded as having essentially the same impact on competing retail firms. Since these excises are imposed, generally, on an ad valorem basis, they tend to magnify the differentials in the prices paid by consumers between firms with differing pretax prices on the taxed items. For example, if because of cost advantages, one store can afford to sell a given item for a specified amount less than its competitor, the imposition of an ad valorem retail excise will serve to spread the difference in the price charged the consumer. Alternatively, some portion of the tax will have to be absorbed by the second firm, resulting in a relative cut in its profits.

On the other hand, it is contended that the differential impact of excise taxation reflects basic differences in efficiency among the taxed firms. While it is agreed that a given excise may not be neutral in its impact, it is contended that its nonneutrality works in the right direction by providing an additional impetus for the relatively inefficient company to find savings in other costs.

Moreover, it is argued, the differential impact as between taxed and nontaxed industries does not constitute an argument against excises but rather against a selective excise system. Replacing the present system of excise taxation with a general system, imposed at uniform rates throughout, it is contended, would eliminate objections that the tax interferes with the free market allocation of resources.

2. Impact on consumption

Since some excises enter industry cost structures and tend to be reflected in the prices of the taxed commodities, they serve to restrict consumption of the taxed articles. There is general agreement that this result is desirable where it is intended to divert resources to defense uses or where consumption of the taxed item has socially undesirable effects, as in the case of narcotics. The same type of argument is frequently applied in the case of excises on luxuries, to which, it is argued, commodity taxation should be largely restricted.

It is contended, for example, that the taxation of luxury commodities involves a relatively low cost in terms of sacrifices of living standards. Restricting the consumption of such goods will result in more resources being devoted to the production of those goods and services which are basic to the material well-being of the entire country. The relative increase in the output of the latter results in a relative lowering of their prices and therefore provides a stimulus for increased consumption.

On the other hand, it is argued that this sumptuary basis for excise taxation involves several basic difficulties. In the first place, it is pointed out that the concept of a "luxury" does not lend itself to objective definition, but depends on arbitrary determinations. Once the excise is imposed, it becomes difficult to remove it, even though what was regarded as a luxury at the time of imposition comes generally to be thought of as a necessity.

Moreover, it is contended that a free market economy depends for its effective operation on free consumer choices with which excises interfere. In a free market, each consumer unit is regarded as having responsibility for allocating its limited consumption budget in such a way as to maximize total satisfaction. It is in this sense only, it is argued, that material well-being is measurable. Accordingly, the imposition of an excise, by discouraging the consumption of the taxed commodity, necessarily results in a reduction in total satisfactions from aggregate consumer purchases.

In addition to the sumptuary basis for excises, they are frequently justified as a means of allocating costs to the beneficiaries of public programs. For example, the excises on gasoline and on automotive equipment are frequently defended as the most desirable means of assuring that the primary beneficiaries of public expenditures on highways will bear a share of the cost of such facilities proportional to the use they make of it. Thus increased public expenditures for roads and highways, it is argued, should be financed by increases in gasoline, automobile, and truck excises, to the extent that the present levies are inadequate.

On the other hand, it is argued, the benefits of an adequate program of public facilities such as highways are widely diffused throughout the economy. All consumer units, it is contended, benefit from the increased quality and lower prices of produce, for example, made possible by a highly developed automotive transportation system. Accordingly, the benefit theory would require a vast number of benefit determinations in order to assure an appropriate allocation of tax costs. Provision for such public programs out of the general revenues, it is argued, more closely fits the benefit criterion than do special excises.

3. Relative revenue emphasis on excise taxation

It is frequently argued that excises should play a larger role in the Federal revenue system. In support of this position, it is pointed out that the Federal revenue system places less emphasis on excises than is to be found in any other major country. The result has been an undue concentration on income taxation, which at both the corporate and individual levels have had, or may be expected to have in normal times, a highly repressive effect on the economy's growth potentials. Heavier reliance on excises, it is argued, would permit a reduction in income taxes, particularly in the highly progressive rates in the individual income tax. In turn, this would reduce the deterrent to undertaking new ventures and would permit a greater rate of the personal savings required to finance business growth.

In answer to this argument, it is pointed out that economic growth in the United States has far exceeded that of other countries where relatively greater use is made of excises. This greater growth, it is contended, has not been in spite of, but rather because of, the secondary role of excise taxation in the Federal revenue system. Excises, it is pointed out, are with few exceptions highly regressive in character, that is, they represent a larger proportion of income the lower the income of the individual. As such, they have a particularly severe effect on consumption outlays among those very groups where the ratio of consumption to income is the highest. It is the growth in consumption expenditures, however, on which continued expansion of industrial facilities depends, since increasing production capacity depends on growing mass markets. Accordingly, it is argued, greater relative emphasis on excises in the Federal revenue system would serve to retard rather than to enhance economic growth.

A further argument offered for greater emphasis on excises is that it would insure greater contribution to the costs of government by a large number of individuals who make no significant contributions through other types of taxes. It is pointed out that in 1951, about 13 million of the 55 million individual Federal income tax returns filed showed no income tax liability. It is contended that every citizen should make some contribution to the costs of Government and that, since those with low incomes substantially escape income taxation, they should be more widely subject to excises.

On the other hand, it is argued, a basic principle of taxation in the United States is that tax burdens should be based on ability to pay. The fact that a substantial number of individuals do not incur Federal income-tax liabilities, it is said, reflects an explicit determination that their incomes are insufficient to warrant tax liability. If it is decided that such low-income individuals should contribute to defraying the expenses of Government, adjustment should be made in the income tax to bring these individuals on to the tax rolls in order to provide assurance that their relative tax contributions will best conform to the ability-to-pay criterion.

Moreover, it is pointed out, excises play a major role in State and local Government revenue systems. Greater use of excises by the Federal Government, it is argued, would not only interfere with States and local finances but would also enhance the regressive features in the combined Federal-State-local revenue structure.

4. Sensitivity of excise revenues to changes in income

A major criticism directed against extensive reliance on excise taxation in the Federal revenue system is the relative insensitivity of the yield of present excises to changes in national income. This insensitivity, it is maintained, is not fortuitous, but follows from the fact that revenue considerations have dictated the selection of items of relatively stable consumption for excise tax.

According to one estimate, the present system of excises results in an 0.8 percent change in revenue yield for each 1.0 percent change in personal income. In other words, the change in yield of such taxes is less than proportional to changes in income. It is argued, therefore, that excises fail to meet what is now regarded as one of the most important criteria applied to elements of the Federal revenue system, namely, that a tax should make a substantial contribution toward automatic stabilization of the economy. By way of contrast, the individual income tax, according to one estimate,[3] has an income elasticity of perhaps 1.6 percent, i. e., the tax yield changes by 1.6 percent for each 1.0 percent change in total adjusted gross income.

According to this view, it should be recognized that adopting any proposal which places relatively greater stress on excises in the revenue

[3] Cf. Pechman, Yield of the Individual Income Tax During a Recession, National Tax Journal, vol. VII, No. 1, March 1954, p. 2.

system necessarily involves willingness to undertake greater discretionary action to offset changes in the level of economic activity. To enhance the built-in elasticity of the Federal revenue system as a whole, it is argued, excises should be reduced whenever possible, so that on balance increasing weight will be placed on highly elastic income taxes.

On the other hand, it is argued that countercyclical tax policy does not require that all elements of the revenue system be highly elastic with respect to income changes. Considerations of the sumptuary and benefit bases for many of our excises, it is contended, outweigh those with respect to built-in flexibility and dictate continued use of these taxes.

Moreover, it is pointed out that the relative insensitivity of the present Federal excise system should not be construed as characterizing all excises. On a selective basis, an alternative excise system might well be devised which would evince considerably greater responsiveness of yield to income changes. A general excise system at uniform rates of tax, which excluded only certain basic consumption items such as food, shelter, and medical care, might well show overall greater flexibility than is found in the present excise system.

B. PROPOSALS

A wide variety of proposals have been offered for revision of the Federal system of excise taxation, ranging from major substantive proposals to suggestions for technical amendments. Of considerable interest currently is the proposal for replacing the present excises with a general manufacturers' sales tax. A somewhat less extreme proposal calls for equalization of rates among manufacturers' excises and among retail sale and other excise taxes. At the opposite extreme are proposals for complete elimination of all Federal excises and the more moderate proposal for progressive rate reduction looking to eventual elimination of the taxes.

1. *General manufacturers' sales tax*

Proposals for a general manufacturers' sales tax have been offered repeatedly since the 1930's and with considerable insistence during the last 2 years. A number of major arguments are offered in support of this type of levy.

In the first place, it is contended that the present system of excises is highly selective and as such penalizes the taxed industries. Even among the taxed industries, the lack of uniformity in tax often results in competitive advantages as between industries producing highly competitive products. Moreover, the wide variety of excises, including those imposed as manufacturers' sales taxes, as retailers' sales taxes, as transactions taxes, and in miscellaneous other forms, results in undesirably varying impact on taxed businesses. A single uniform levy, it is urged, would remove the inequities and anomalies inherent in the present highly disparate system.

Secondly, it is claimed that on the basis of administrative considerations, excises should be levied only upon the sale of the taxed articles by the manufacturer. This would provide savings in administrative costs since there are far fewer manufacturers than retailers and wholesalers, and manufacturing establishments may generally be counted on to have more highly developed accounting systems than the numerous small retail firms.

It is also pointed out that the present system of excises frequently involves rates so high as to reach the point of diminishing returns. The example most often cited is the tax on alcoholic beverages, which at present levels is regarded by many as responsible for a significant increase in bootleg sales and a persistent lack of increase in legitimate sales in spite of higher incomes and larger population. Selective rate reductions, however, are not the answer, it is argued, since they necessarily give rise to claim for similar preference in other excises, resulting eventually in a total revenue loss so large as to pose a serious budgetary problem. Accordingly, it is argued that the only practicable way in which prohibitively high rates of excise tax can be reduced is by providing for a general excise system producing the same total revenue as the present selective excises.

Finally, it is argued that only by adopting a general excise system can the unduly heavy burden of progressive income taxation be relieved. Rates in the income tax are regarded as so high as to represent a significant deterrent to sustained economic growth. Furthermore, it is evident that if such rates are required while the country is in a relatively peaceful era, income taxation cannot be counted on to provide the fiscal resources which would be required if a substantially larger defense program were required. Fiscal preparedness, it is claimed, requires the adoption of a general excise system.

In opposition to this proposal, it is argued that a general excise, whether at the manufacturers' or retailers' level, would violate the basic concept of equity in the Federal revenue system. It is this ability to pay concept which is the basis for progression in our income tax. A general sales tax, however, would involve substantial regressivity. This would be true, it is claimed, since the tax could not feasibly be applied to most services which represent an increasing proportion of total consumption as income rises. In addition, the tax would be imposed only on spending and since low-income individuals generally have no net savings out of current income, the tax would bear far more heavily on them than on upper income groups. Even if, as frequently proposed in connection with a manufacturers' sales tax, specific exemptions were provided for food, medicine, and shelter, the tax, it is alleged, would nevertheless remain regressive overall.

In addition to its regressivity, a general sales tax, it is argued, would penalize consumption and favor savings. This would be especially true if the tax were designed to produce a significant increase in revenue compared with the present excise system. This result may be tolerable in times of war or heavy defense emergency programs. At other times, it is argued, it would represent a significant deterrent to sustained economic growth. Despite the general bias in favor of thrift, it is contended, too high a savings ratio places an inordinately high burden on private investment and Government spending to sustain full employment. The historical record, it is alleged, shows no deficiency in personal savings, while on the contrary inadequate consumption expenditures are largely responsible for economic reverses.

Objections to a Federal general sales tax are also voiced by those concerned with the financial problem of State and local governments. It is contended that general sales taxation represents one of the major fiscal devices, actual and potential, available to these governments as a means of financing their growing spending programs. The adoption of a Federal levy of this character, it is claimed, would further circumscribe the fiscal autonomy of State and local governments and result in an increasing level of Federal responsibility for programs traditionally undertaken at the State or local level.

In addition to these general objections to Federal sales taxation, specific objections are raised to a general manufacturers' sales tax. It is claimed that such a tax would tend to be pyramided by the time it reached the final consumer so that the net effect on consumer goods prices would exceed that of the tax alone.

Moreover, it is contended that a traditional requirement of a "good" tax is that the taxpayer be conscious of its imposition. In the case of a manufacturers' sales tax, however, the tax is "buried" in the final price paid by the consumer, so that unless the retailer is under compunction to state the amount of the tax included in the price of the article, the consumer will be unaware of his tax payment.

2. Rate uniformity

Under a somewhat less extreme proposal than that for a general sales tax, it is suggested that Federal excise revision be directed primarily toward providing a uniform system of rates for all commodities and transactions now taxed. Specifically, it is proposed that all Federal excises be placed on an ad valorem basis and at a single rate or system of rates which will provide about the same total revenue as the present excise system.

In support of this proposal, it is argued that the lack of uniformity in rates involves excessively high rates on some items and rates that are too low on others, in view of the competitive relationship among the producers and sellers of the taxed articles. The ad rem basis for many of the present excises, it is contended, often results in significant disparities in the impact of the tax on prices and profits. Tobacco products and alcoholic beverages are frequently cited in illustration of this point.

On the other hand, it is pointed out that uniformity in rates was substantially achieved by the Excise Tax Reduction Act of 1954. Where nonuniformity persists, it is maintained, the sumptuary, benefits, and regulatory bases of such excises preclude uniformity in rates. In some cases, it is argued, rates are set relatively high in order to discourage the use of the taxed item. In others, the rates tend to move, at least over time, in response to changes in benefits provided by Federal spending programs. In still other cases, the rates reflect efforts to exact maximum revenue from the taxation of articles the consumption of which is of marginal social importance. Uniformity in rates, therefore, would often interfere with the purposes intended to be served by the excise.

3. Elimination of Federal excises

Persistent proposals have been made for the reduction of Federal excises, leading to the eventual elimination from the Federal revenue system of all excises except, perhaps those on liquor, tobacco, and gasoline. The arguments offered by proponents of this approach have been stated above. In summary, it is contended that considerations of equity, of economic stabilization, and of providing a high level of consumption to assure continued economic growth require a continuing deemphasis of most, if not all, excises and their eventually complete elimination as a Federal tax device.

Many of the arguments opposed to this position are also indicated above. In addition, it is pointed out that excises, though not a major element of the Federal revenue system, nevertheless represent between one-sixth and one-seventh of total Federal tax collections. Their elimination, therefore, would require a further burdening of taxpayers through the individual income tax. In the context of the present revenue requirements, it is contended, complete elimination of all excises would require an initial bracket rate in the individual tax of over 25 percent or a combined corporate tax rate of close to 70 percent.

CORPORATE INCOME TAXATION

The Federal corporation income tax originated in an excise tax, enacted in 1909, which was levied at the rate of 1 percent on net income in excess of $5,000. The corporation excise tax was superseded by the 1913 income-tax law (actually a section of the Underwood-Simmons Tariff Act) which followed the adoption of the 16th amendment empowering Congress to "lay and collect taxes on income from whatever source derived * * *."

The corporation income tax has been an important part of the Federal revenue system since the enactment of the 1913 law. Over the four decades of its existence, the tax has contributed between one-sixth and one-half of total Federal tax revenues. In the post World War II period the corporate income tax has been second only to the individual income tax in revenue importance.

I. Structure of the Corporate Income Tax

A. TAX RATES

The corporate income tax consists of a normal tax of 30 percent on the total amount of taxable income and a surtax of 22 percent on taxable income in excess of $25,000.[1] Effective tax rates, therefore, range from 30 percent on income less than the surtax exemption to nearly 52 percent, as shown in the following table:

Taxable income	Tax	Effective rate (percent)
$5,000	$1, 500	30. 00
$25,000	7, 500	30. 00
$50,000	20, 500	41. 00
$100,000	46, 500	46. 50
$500,000	254, 500	50. 90
$1,000,000	514, 500	51. 45
$10,000,000	5, 194, 500	51. 95

Federal corporate income tax rates have shown a general upward trend since the enactment of the first income-tax law. Following the 1913 law, corporate tax rates were increased gradually to 12 percent in 1918 and ranged from 10 to 13½ percent during the 1920's. In 1936 graduated rates were introduced, ranging from 8 to 15 percent and supplemented by a surtax on undistributed profits ranging from 7 to 27 percent. This undistributed profits tax was removed in 1938 and graduation in rates was limited to corporations with net incomes of $25,000 or less.

Tax rates ranging from 25 to 40 percent were imposed throughout most of World War II. These were supplemented by an excess profits tax which for the income years 1943 to 1945 brought the maxi-

[1] Sec. 11.

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mum combined effective rate to 80 percent. For the postwar years, effective rates ranged from 21 to 38 percent.

Beginning with the income year 1950, the system of graduated rates for corporations with taxable incomes less than $25,000 was replaced with a single normal tax rate applicable to the full amount of taxable income and a surtax applicable to taxable income in excess of a specific $25,000 surtax exemption. Under the impetus of the Korean emergency revenue requirements, rates were increased to the present level and were supplemented by an excess profits tax of 30 percent, subject to an overall effective ceiling rate of 70 percent. The excess profits tax expired on January 1, 1954.

B. TAX BASE

The taxable income of a corporation to which the above tax rates apply is a statutory concept derived, in general, by deducting from gross income the expenses incurred in securing that income. Certain types of income, however, are not subject to the full normal and surtax rates or are excluded from gross income under certain types of circumstances. Moreover, various types of corporations are fully or partially exempt from tax, on condition of meeting certain qualifications. Finally, certain deductions are allowed which do not accurately measure costs in a strict accounting sense.

1. Special types of income

Long-term capital gains are taxed at an alternative rate of 25 percent. By statutory definition these gains are those arising from the sale or exchange of capital assets held by the taxpayer for at least 6 months. Capital assets are broadly defined as any property held by the taxpayer except such business assets as merchandise and depreciable and real property used in the trade or business. However, statutory rules have extended the alternative capital gains treatment to special types of income, including profits on sale of depreciable and real property used in the trade or business, timber, livestock, land with unharvested crops, and coal royalties. Any net losses realized on the sale of property giving rise to these incomes are deductible in full against other taxable income.[2]

Special tax treatment is also afforded for gains arising out of corporate reorganizations. The basic purpose of these special provisions is to avoid imposing a tax on profits arising out of transactions which do not basically alter the continuity of an economic interest and, therefore, to avoid tax barriers to normal business adjustments. In general these provisions permit the sale or exchange of property, without tax recognition of gain or loss, when the transaction is involved in a merger, consolidation, recapitalization, or change in identity or legal form of organization. To qualify for the tax-free treatment, certain limitations are imposed in order to prevent tax avoidance through the fictitious realization of losses or the capitalization of untaxed income.[3]

Dividends received by a corporation by virtue of ownership of stock in another domestic corporation are included only to the extent of 15 percent in the recipient company's taxable income.[4] Complete exemption is provided for dividends received from an affiliated cor-

[2] Subch. P, passim.
[3] Subch. C, passim.
[4] Sec. 243.

poration where the affiliated companies exercise the privilege of filing consolidated returns. In such cases, however, a special additional 2-percent tax is imposed on the consolidated taxable income of the group.[5]

Special provisions also apply with respect to the taxability of income derived by a corporation from foreign sources. As a result, some of this income is entirely exempt from the United States corporation income tax, some is partially exempt, and on some the tax is postponed.[6]

2. Special classes of corporations

Certain special classes of corporations are exempt from the Federal corporate income tax. The law, for example, exempts a variety of corporations which qualify as nonprofit companies. Such companies include charitable, educational, religious, scientific, and literary organizations and mutual and cooperative societies.[7] In recent years, however, provision has been made for the partial taxation of these organizations under certain circumstances. Educational and charitable institutions, for example, are taxed on profits derived from activities which are not substantially related to the purpose constituting the basis for their exemption.[8] Cooperatives may be taxed on earnings in excess of those distributed as cash or merchandise dividends or allocated to patrons.[9] Mutual savings banks and building and loan associations are taxed on their net income after the usual business deductions, including interest to depositors and required reserves for future losses.[10]

Regulated investment companies meeting certain specific requirements are treated as "conduits" of income and are taxed only on their undistributed earnings. To qualify for this treatment, the company must derive at least 90 percent of its gross income from dividends, interest, or gain from the sale of stock or securities. In general, at least 50 percent of the company's portfolio must consist of holdings no one of which exceeds 10 percent of the voting securities of the issuer or 5 percent of the assets of the regulated investment company. Exception is made to permit regulated investment companies furnishing capital for so-called development companies to hold more than 10 percent of the voting stock of such companies. No more than 25 percent of the value of the total assets of the regulated investment company may be invested in any one company or group of associated companies under the investment company's control. Finally, the investment company must distribute at least 90 percent of its ordinary income to its shareholders.[11]

3. Deductions for business expenses

In general, all ordinary and necessary expenses incurred in carrying on a trade or business are deductible in arriving at taxable income.[12] Such expenses include wages and salaries for labor and executives' services, rents, repairs, bad debts, costs of materials, casualty losses, taxes, and interest payments. No deductions, however, are allowed for dividends paid by the corporation. Accordingly, the deduction of

[5] Sec. 1503.
[6] See Taxation of Income from Foreign Sources.
[7] Secs. 501, 521.
[8] Secs. 511, 512.
[9] Secs. 521, 522.
[10] Secs. 591–593.
[11] Secs. 851–855.
[12] Sec. 162.

payments for interest, rents, and royalties results in the inclusion in the tax base of only the return to equity capital.

In general, the cost of fixed capital equipment is not fully deductible in the year the equipment is acquired but must be spread over the asset's life, in accordance with certain methods specified in the tax law.[13] Exception is made in the case of defense production facilities which are certified as eligible for rapid amortization. In such cases the certified portion of the facility's costs may be written off over a 5-year period regardless of its customary useful life.[14]

Special provisions are also applicable to capital costs in the extractive industries.[15] Taxpayers are afforded an alternative to the writeoff of their investment in depletable properties over the useful life of the properties. The alternative deduction is computed as a specified percentage of the gross income derived from the property but not in excess of 50 percent of the net income from the property. Unlike depreciation, these percentage depletion allowances are not limited to the taxpayer's investment in the property but may be claimed so long as the property continues to produce income.

Special treatment is also accorded certain capital costs incurred in exploring for and developing mineral properties. Such costs may be deducted either as current expenses or in the case of mines over the useful life of the minerals benefited.

C. CHARACTERISTICS OF THE CORPORATE TAX BASE

One of the most significant characteristics of the corporation income-tax base is its volatility. Although the total number of corporation income-tax returns has not changed substantially from year to year in the post-World War II decade, the proportion of these tax returns showing taxable income has varied widely. In addition, short-run changes in total corporate income tend to be relatively greater than variations in national income. This variability in the corporate tax base is shown in the following table.

Corporation income tax returns and net increase, 1946–52

[Dollar amounts in billions]

Year	Total number of returns [1]	Returns with net income [2]		National income	Total net income reported [3]	
		Number	Percent of total returns		Amount	Percent of national income
1946	491,152	359,310	73.2	$179.6	$25.2	14.0
1947	551,807	382,531	69.3	197.2	31.4	15.9
1948	594,243	395,860	66.6	221.6	34.4	15.5
1949	614,842	384,772	62.6	216.2	28.2	13.0
1950	629,314	426,283	67.7	240.0	42.6	17.8
1951	652,376	439,047	67.3	277.0	43.5	15.7
1952 [4]	672,071	442,577	65.9	289.5	38.5	13.3

[1] Active corporations only.
[2] Before net operating loss deduction.
[3] All returns. Amount shown is total net income less total net deficit.
[4] Preliminary.

Source: Internal Revenue Service, Statistics of Income, pt. 2, 1951 and Preliminary, 1952; Department of Commerce, Survey of Current Business, July 1955.

[13] Sec. 167. See Depreciation.
[14] Sec. 168.
[15] Sec. 611–616. See Taxation of Income From Natural Resources.

Some smoothing of the fluctuations in the corporate income-tax base results from the loss carryover provisions in the tax law. Under the present law, losses may be carried back and offset against the taxable income of the preceding 2 years and carried forward as offsets against the taxable income of the succeeding 5 years. In effect, therefore, corporate income and losses may be averaged over an 8-year period.[16]

As shown in the following table, the bulk of taxable corporate income is concentrated in a relatively few large corporations. Of the 439,047 corporate returns with net income in 1951, 347,275 or 79.1 percent reported taxable incomes under $25,000. These accounted, however, for only 5.0 percent of the aggregate net income reported. On the other hand, 32,054 companies with incomes above $100,000 or 7.3 percent of all corporations with net income accounted for almost 90 percent of the total corporate income. In view of the heavy concentration of corporate profits among the largest companies, the volatility of the corporate income-tax base may be attributed largely to the changes in profits of these larger companies.

Corporate returns and net income, by net income classes, 1951

Net income classes	Returns[1]		Net income	
	Number	Percent of total (cumulative)	Amount (thousands)	Percent of total (cumulative)
Under $25,000	347,275	79.1	$2,270.2	5.0
$25,000 under $50,000	36,933	87.5	1,284.6	7.8
$50,000 under $100,000	22,785	92.7	1,595.2	11.4
$100,000 under $250,000	17,183	96.6	2,662.6	17.2
$250,000 under $500,000	6,656	98.1	2,316.0	22.3
$500,000 under $1,000,000	3,693	99.0	2,569.2	28.0
$1,000,000 and over	4,522	100.0	32,635.3	100.0
Total	439,047		45,333.2	

[1] Includes only returns with net income.

Source: Internal Revenue Service, Statistics of Income for 1951, pt. 2.

II. Issues in Corporate Income Taxation

A. Relative Emphasis on Corporate Income Taxation in the Federal Revenue System

The proper role of the corporate income tax in the Federal revenue system has long been the subject of dispute among students of taxation. It is argued by some that the sole basis for taxing corporations is the benefit derived from the privilege of doing business in the corporate form. Exponents of this view hold that the corporate tax should properly be regarded as a franchise tax which should be imposed at rates far more modest than those in effect in recent years. Others maintain that the position of corporate enterprise in the national economy requires a more intensive use of corporate income taxation, particularly with a view to reaching monopoly profits. Between these two extremes, a widely held view is that because incorporated business controls the use of a substantial portion of the economy's resources, corporate profits are necessarily an important subject of income taxation. According to this view, corporate income-

[16] Sec. 172.

tax policy should be based on broad economic objectives such as smoothing out fluctuations in the level of economic activity and improving income distribution in order to maintain a steady rate of economic growth.

The debate over the proper place of the corporation income tax in the revenue system is complicated by disagreement with respect to the incidence of the tax. According to one view, a substantial portion of the total corporate levy is shifted forward to consumers through price adjustments reflecting the tax, while most of the remaining burden is shifted backward to shareholders and to the productive services employed by corporations. Such an incidence pattern characterizes the corporate income tax as a sales tax, subject to the criticism frequently directed against consumption taxes with respect to their inequitable burden distribution and adverse effects on competitive relationships. Proponents of this view generally argue that corporate income taxation should be assigned a relatively minor role in the revenue system and should be regarded primarily as a device for source collection of shareholders' income-tax liabilities.

Opposed to this position is the view that the corporation income tax is not shifted, at least in the short run. It is argued that the most profitable output of the corporation in the short run is the same whether or not an income tax is imposed. Accordingly, so long as demand remains unchanged short-run price adjustments intended to pass on changes in corporate income-tax liability will not increase the corporation's profits after tax. While proponents of this view concede that over the long run the corporation income tax may be reflected in the price structure, they nevertheless hold that alternative methods of taxation which would produce the same revenue would have a significantly more adverse and more immediate impact on the distribution of real income and on economic growth and stability.

The revenue importance of the present corporation income-tax system tends to preclude any drastic changes over a short period of time. Combined with its revenue significance, the sensitivity of the corporate income-tax yield to changes in economic conditions makes it an important element in countercyclical fiscal policy. Proposals for basic change in the role of corporate income taxation, therefore, require consideration of the impact of such changes on the overall effectiveness of the tax system in damping down short-term fluctuations from long-term economic growth trends.

B. SPECIFIC PROBLEMS IN CORPORATE INCOME TAXATION

1. *Dividend distributions*

One of the most frequently recurring issues in corporate income taxation concerns the treatment of dividend distributions. Under the present law a corporation may not claim tax deductions for the amount of dividends it distributes to its shareholders. Under the provisions of the Internal Revenue Code of 1954, however, individual dividend recipients are permitted to exclude from their taxable incomes the first $50 of dividends received and to claim a credit against their final tax liabilities equal to 4 percent of dividends received in excess of the exclusion.[17] Under the 1939 Revenue Code, dividends were fully subject to both normal tax and surtax in the hands of individuals.

[17] Secs. 116 and 34.

The treatment of dividends under the 1939 code was criticized on two scores. In the first place it was argued that the tax law imposed a severe double tax on this form of income and was, therefore, grossly inequitable. This criticism was based on the characterization of the corporation as merely an income conduit for its owners rather than as a separate economic entity. According to this view, the individual stockholder's share of corporate income was taxed twice, once as received by the corporation and again in the shareholder's hands when distributed as a dividend. Moreover this double taxation was regarded as particularly heavy on low-income dividend recipients since the combined corporate and individual tax on a dollar of corporate income (at current rates) was about 96 cents for a top-bracket individual—about 5 cents above his individual liability alone, and nearly 62 cents for first bracket shareholders—about 42 cents greater than the tax payable on a dollar of, say, wage income. The dividend exclusion and credit provisions of the 1954 code are regarded by proponents of this view as initial steps in the correction of this discriminatory double taxation of dividend income.

Apart from the double taxation argument, the present tax treatment of dividends has also been criticized as imposing a bias against equity financing by corporate enterprise. The deductibility of interest payments by corporations, it is argued, induces an undue concentration on debt financing which may significantly circumscribe the company's flexibility and willingness to undertake new and relatively risky ventures and limit its ability to adjust readily to changing business conditions. Thus, at a time of downward business adjustments, the heavily debt-laden corporation may find the required adjustment particularly difficult, or even impossible.

Opponents of this relief for dividend income point out that the alleged double taxation of dividend income is greatly exaggerated. Stockholders, it is claimed, do not base their decisions with respect to stock purchases on the basis of pretax corporate earnings per share, but rather on the basis of after-tax earnings available for distribution. Accordingly, it is argued, shareholders take full account of the corporate income tax in determining the price they will offer for a corporation's stock. Having discounted the corporate tax in the purchase price of the stock, shareholders are subject only to the individual tax on distributed corporate earnings. The added burden of the corporate tax, therefore, is limited to those who purchased stock before an increase in taxes. Because of the high turnover in corporate shares, this double tax burden tends to be concentrated among older shareholders with inactive portfolios. Even in such cases, however, this burden may be mitigated by the fact that taxes tend to be increased under inflationary conditions which tend to drive stock prices up and thus offset, at least in part, the fall in stock prices which otherwise would result from the discounting of the increased corporate tax.

It is also pointed out that tax considerations generally are not dominant in determining the form of financing sought by corporate enterprise. It is argued that one of the principal limitations on equity financing stems from the desire on the part of existing shareholders to avoid dilution of their interest through additional equity issues. Furthermore, it is maintained that the character of the market for the supply of capital funds is another important factor in determining the form of corporate financing. This market, it is claimed, is dominated by institutional investors such as commercial banks, savings banks, insurance companies, and trusts which are generally restricted, either by legal requirements or by traditional investment practice, to high-grade bonds. Finally, it is argued that a very large proportion of the capital funds required by corporations are derived internally. Taking such funds into account, no significant overloading of debt in corporate financial structures is generally observable.

Developments in corporate financing since the end of World War II do not offer convincing evidence with respect to the impact of corporate income taxation on financial policy. The following table indicates that changes in the composition of new corporate funds are poorly correlated with changes in tax rates.

Corporate income and excess profits tax rates [1] and sources of corporate funds, 1946–54

[Dollar amounts in billions]

	1946	1947	1948	1949	1950	1951	1952	1953	1954
Tax rates (range):									
Income ... percent	21-38	21-38	21-38	21-38	23-42	28¾-50¾	30-52	30-52	30-52
Excess profits tax ... do	------	------	------	------	15	30	30	30	------
Combined ... do	21-38	21-38	21-38	21-38	[2] 23-57	[3] 28¾-80¾	[4] 30-82	[4] 30-82	30-52
Source of corporate funds:									
Internal:									
Total	11.4	16.6	18.6	14.7	20.2	18.1	17.6	19.5	19.5
Retained profits [5]	7.2	11.4	12.4	7.6	12.4	9.1	7.5	8.3	7.0
Depreciation	4.2	5.2	6.2	7.1	7.8	9.0	10.1	11.2	12.5
Net new issues:									
Total	2.4	4.4	5.9	4.9	3.7	6.3	7.9	7.3	6.5
Stocks	1.3	1.4	1.2	1.6	1.7	2.7	3.0	2.4	2.5
Bonds	1.1	3.0	4.7	3.3	2.0	3.6	4.9	4.9	4.0
Total	13.8	21.0	24.5	19.6	23.9	24.4	25.5	26.8	26.0
	Percentage distribution								
Internal:									
Total	82.6	79.0	75.9	75.0	84.5	74.2	69.0	72.8	75.0
Retained profits	52.2	54.3	50.6	58.8	51.9	37.2	29.4	31.0	26.9
Depreciation	30.4	24.8	25.3	36.2	32.6	36.9	39.6	41.7	48.1
Net new issues:									
Total	17.4	21.0	24.0	25.0	15.5	25.8	31.0	27.2	25.0
Stocks	9.4	6.7	4.9	8.2	7.1	11.1	11.8	8.9	9.6
Bonds	8.0	14.3	19.2	16.8	8.4	14.8	19.2	18.3	15.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

[1] Calendar year corporations.
[2] Combined ceiling rate was 52 percent.
[3] Combined ceiling rate was 68 percent.
[4] Combined ceiling rate was 70 percent.
[5] Including depletion

Source: U. S. Cong., Senate Committee on Banking and Currency. Factors Affecting the Stock Market (staff report to the committee), Washington, U. S. Government Printing Office, 1955, p. 68. Based on Securities and Exchange Commission and other financial data; U. S. Treasury Department, Statistics of Income, pt. 2.

During the period 1946 through 1948 when tax rates remained stable, both internal and equity financing declined percentagewise, while debt financing increased. In 1949, at the same tax rate as in the preceding 3 years, equity financing increased proportionately while both internal and debt financing decreased. In 1950, when the corporate income tax was increased and the Korean excess-profits tax was introduced, internal financing increased very substantially, both in absolute and proportional terms; debt financing decreased by 50 percent as a fraction of the total, while the proportion of equity financing decreased slightly. External financing, both through stocks and bonds, increased substantially in 1951 despite an increasing weight of income and excess-profits taxation. In 1952, under the continuing impact of the excess-profits tax, corporations continued to rely increasingly heavily on external sources, most noticeably debt. A shift to internal sources of funds is to be observed in 1953.

The data with respect to corporate financing since the enactment of the 1954 Internal Revenue Code indicate that the new dividend provisions for individuals have had no material impact on increasing equity issues. Total new issues in the first half of 1955 are estimated at $3.0 billion of which stocks comprise $1.0 billion or 33⅓ percent. By comparison, in the first half of 1954 (before the dividends received credit and exclusion provisions were applicable), total issues amounted to $3.4 billion of which stocks were $1.5 billion or about 44.1 percent.[18]

Aside from the dividend exclusion and credit provisions in the present tax law, two basic alternative proposals have been offered for revision of the tax treatment of dividends. The first of these is based on the concept of the public corporation as a separate economic entity, in contrast with the notion of the corporation as merely an agency for its stockholders. Under this concept, the form of the contract by which the corporation acquires financial resources externally is not relevant in determining the tax treatment of payments made for these resources. Since the tax law permits deductions for virtually all resources payments, deductions should also be allowed for such payments which take the form of dividend distributions. Allowing a deduction for dividends paid, it is argued, would eliminate an illogical bias (however significant it may be in practice) against the acquisition of external financial resources under stock contracts. Moreover, it would impel more liberal dividend distribution policies and, therefore, increase the dependence of corporate enterprise on external funds for financing growth and new ventures. Such dependence is to be encouraged as a means for securing more frequent and more objective appraisals of the relative value of alternative investment programs and, therefore, as a means of assuring the best possible allocation of investable resources.

This proposal has been opposed as representing an undue interference by the tax system in the financial policies of corporations. Since allowing a deduction for dividends would mean that the corporation would pay a tax only on retained earnings, the corporate income tax would be converted into an undistributed-profits tax. As such, it would impose heavy pressure on management to distribute earnings without due reference to the corporation's financial requirements. It would, moreover, result in a shift in the distribution of the total corporate income-tax burden to relatively small and new companies whose dependence on retained earnings is relatively great.

The second basic alternative is modeled after the treatment of dividends in the United Kingdom. Under this approach, the corporate tax, or a portion thereof, would be regarded as withholding of the shareholder's individual income-tax liability on his share of the corporate earnings. The actual amount of dividends received would be

[18] Department of Commerce, Survey of Current Business, December 1955, p. 12.

"grossed up" to account for the tax withheld at the corporate level, the individual tax liability would be computed on the gross amount, and a credit would be taken against the individual's tax for the corporate withholding. For example, if the corporate withholding rate were determined to be 20 percent (i. e., 20 percentage points of the present corporate tax regarded as withholding of the individual tax liability) a dividend receipt of $100 would be grossed up by the dividend recipient to $125. The full individual tax liability would be computed on the $125 and a credit against the individual liability in the amount of $25 would be allowed.

Proponents of this approach urge that it would substantially overcome the tax bias against equity financing and because of the grossing-up feature would preclude an individual credit in excess of the double tax involved. On the other hand, it is argued, this approach is unduly complicated and is only remotely related to the basic discrimination at the corporate level against equity financing.

2. Taxation of small and new businesses

A continuing issue in corporate income taxation concerns the relative impact of the tax on small and new businesses as compared with large and established firms. It is generally conceded that vigorous, small business enterprises are vitally important to a healthy, competitive structure in our economy. Of particular importance is the rate at which new businesses are formed and their ability to survive and to become established as successful business units.

The Federal tax structure has been criticized as failing to make a positive contribution to the promotion of new and small business and even as contributing to a decline in the relative importance of small business in recent years. These criticisms have embraced virtually the entire Federal revenue system but with particular emphasis on the tax treatment of capital gains and losses, estate and gift taxes, and the corporation income tax. Particularly with respect to the latter, numerous proposals have been made either to provide deliberate tax advantages to small and new business as an offset to some of their nontax disadvantages or to remove what are regarded as inherent discriminations in the law.

In general, the basic problems associated with small and new businesses are thought to stem from their difficulty in securing the financial resources required for growth and development. In the case of the new business, the principal difficulty, it is alleged, lies in securing the capital needed to tide the company over the formative and development stages to the point at which profitable operations begin. In the case of the established small business, the major problem, it is contended, is to assure continuation of a supply of capital adequate at least to maintain the company's position in its industry and to permit it profitably to resist the inducements offered for absorption in larger business units. The sources of these difficulties are generally identified as the inaccessibility of the market for equity funds, the differentially burdensome terms upon which credit (particularly long term) may be obtained, and the inadequacy of retained earnings and capital recovery allowances.

The two major features of corporate income taxation which are most significant in this connection are the rate structure and the treatment of retained earnings.

(a) *Rate structure.*—The present corporation income-tax rate structure is frequently characterized as disproportionately burdensome on new and small corporations. It is alleged that the present 30-percent normal tax, applied to the full amount of net earnings, and the 22-percent surtax on net earnings in excess of $25,000 does not adequately differentiate the taxpaying ability of small companies from their larger competitors.

Specifically, it is maintained that where net earnings are under $25,000, a 30-percent levy leaves a small company with retentions far too meager to generate an adequate increase in the flow of earnings. Moreover, it is claimed that imposition of the additional 22-percent surtax on earnings between $25,000 and $50,000 or $100,000 involves a combined rate so high as to limit very severely the growth potential of a small company in this income range.

The principal alternative proposals which have been offered to provide relief to small and new companies are (1) complete exemption of the first, say, $25,000 of net earnings of new companies for a limited period of time, e. g., 3 years, (2) restoration of the type of limited rate graduation in effect prior to 1950, (3) introduction of full-rate graduation for all corporations regardless of the amount of their taxable income, (4) increase in the surtax exemption, and (5) decrease in the normal tax rate and increase in the surtax rate.

(1) *Full exemption of a limited amount of earnings of new companies*

This proposal would seek to offer positive encouragement for the formation of new businesses. It recognizes that a relatively rapid rate of capital accumulation frequently is essential during the early years of the life of an enterprise and that this process requires a relatively heavy net inflow of funds both from outside and internal sources. In addition to permitting a greater rate of retention of net earnings, the proposal would also facilitate external financing since the Government would, in effect, underwrite the new company's equity or debt issues, at least for the first few years.

Several objections may be raised to this proposal. In the first place it would significantly discriminate against unincorporated new businesses unless similar treatment were provided in the individual income tax where very troublesome equity and enforcement problems would have to be surmounted.

Secondly, providing special tax treatment of this character for a limited group of taxpayers would tend to set up pressures for extension of the preferential treatment to other taxpayers with perhaps equally pressing, though dissimilar, financial problems. The inducements to tax avoidance that this proposal would afford would also be difficult to control. For example, it would be extremely difficult to define a "new" corporation. Would a "new" corporation resulting from a reorganization be eligible for this special exemption? Would the special exemption be available to closely held family corporations which may be readily proliferated?

(2) *Restoration of limited rate graduation*

Under the system of limited graduation in effect prior to 1950, graduated rates were applied only in the case of a corporation whose income did not exceed some designated amount. In the case of corporations with incomes in excess of this amount, a single tax rate was applied to the full amount of taxable income. For example, for the income years 1946 through 1949, the following normal and surtax rate schedules were applicable:

[Percent]

Taxable income	Normal tax rate	Surtax rate	Combined marginal rate
Incomes in total amount—			
Not over $50,000:			
First $5,000	15		21
Next $15,000	17	6	23
Next $5,000	19		25
Next $25,000	31	22	53
Over $50,000	[1] 24	[1] 14	[1] 38

[1] Of entire income.

Combined rates ranged from 21 percent on $5,000 or less of taxable income to 38 percent on incomes over $50,000. In the range between $25,000 and $50,000 of taxable income, a marginal or "notch" rate of 53 percent was imposed.

This high "notch" rate was required in order to provide a relatively smooth progression of effective rates on incomes up to $50,000 in view of the fact that both the marginal and effective rate on the full amount of taxable income was 38 percent where taxable incomes exceeded $50,000. Effective rates under this graduated rate schedule were as follows:

Taxable income	Amount of tax	Effective rate (percent)
$5,000	$1,050	21.00
$20,000	4,500	22.50
$25,000	5,750	23.00
$30,000	8,400	28.00
$40,000	13,700	34.25
$50,000	19,000	38.00
Over $50,000	------------	38.00

Proponents of this type of rate structure contend that it best meets the objective of differential taxation of small and large companies since the benefits of the lower graduated rates are confined to companies with relatively low incomes.

On the other hand, because of its dependence on a high "notch" rate, this system of graduation was severely criticized when it was in effect. Thus the 53 percent "notch" rate was regarded as imposing a heavy penalty on corporations with incomes between $25,000 and $50,000 since it served to take a larger share of additional earnings in this range than was taken by the 38 percent rate on additional earnings in excess of $50,000.

Moreover, this method of graduation made it extremely difficult to change the alinement of rates in order to increase the spread between the preferential rate on small companies and the standard rate. In order to do so, it was necessary either to increase the "notch" rate, further aggravating the problem described above, or to provide a disproportionately large increase in the effective rate on income under $25,000.

For example, in order to increase the combined rate on incomes over $50,000 by 4 percentage points to 42 percent, a "notch" rate of 61 percent would have been required if the rates on income under $25,000 were to be unchanged. Alternatively, to avoid any increase in the 53 percent "notch" rate, the tax on an income of $25,000 would have had to have been increased by $2,000, or about 35 percent, to $7,750.

(3) *Full rate graduation*

Under this method a graduated rate structure similar to that in the individual income tax would be provided for all corporations regardless of the amount of their total income. Proponents of this system point out that it would provide increasing tax liabilities to reflect progressively increasing Government benefits as corporate income increases. Tax benefits, moreover, would tend to vary directly with the need for internal financing of growth, which is most pronounced in the case of small companies.

Critics of this proposal point out that full graduation would extend the benefits of preferentially lower rates of tax on specified amounts of income to all corporations and would, therefore, tend to be inconsistent with the purpose of graduation. Moreover, full graduation would impose a relatively heavy penalty on small, risky businesses with fluctuating incomes as compared with less venturesome enterprises with the same total income over a period of years. In addition, full graduation would provide greater inducements for corporate splitups than prevail under the present law. Whatever the arguments for or against such reorganizations on the basis of nontax considerations, it is maintained that they should not result in preferential tax treatment so long as a community of ownership and managerial control persists. Finally, it is contended that it would be virtually impossible to determine appropriate brackets and degree of graduation, since the generally accepted notions of intertaxpayer relationships, which may be used in determining rate graduation in the individual income tax are not applicable in the case of corporations.

(4) *Increase in the surtax exemption*

Proponents of an increase in the surtax exemption contend that it would serve the objective of providing differential relief for small firms without the major conceptual and practical difficulties involved in proposals for rate graduation. Thus, it is argued that increasing the surtax exemption would effectively decrease the amount of income of small companies subject to the full corporate tax rate without unduly aggravating the penalty on risky business and without too greatly enhancing inducements for corporate splitups afforded by rate progression.

On the other hand, those opposed to an increase in the surtax exemption point out that in addition to the very sizable revenue loss involved, the benefits of the increased surtax exemption could not be confined to the small companies for which it was intended. While the effective rate reductions for large companies would be small, these companies would, nevertheless, obtain a disproportionately large share of the total reduction in tax liabilities. It is estimated, for example, that a $100,000 surtax exemption would result in tax reductions aggregating close to $1 billion, of which corporations with incomes over $100,000 would obtain about 65 percent.

(5) Decrease in the normal tax rate, increase in the surtax rate

Under present law, the normal tax rate is scheduled to decrease 5 percentage points, from 30 percent to 25 percent, on April 1, 1956. The present surtax of 22 percent would be continued, resulting in a combined marginal rate of 47 percent on income in excess of $25,000. The scheduled rate decrease would result in a revenue loss estimated at close to $2 billion on a full-year basis.

In view of the substantial revenue loss involved in the pending rate reduction and the disputed priority of general corporate tax reduction, it has been proposed that the scheduled decrease in the normal tax rate be compensated for by a corresponding increase in the surtax rate. Thus a 25 percent normal tax would be combined with a 27 percent surtax on incomes in excess of $25,000. The revenue loss from this proposal is estimated at about $225 million on a full-year basis at current levels of corporate income. Almost 50 percent of this tax reduction would be on account of corporations with incomes under $25,000 and about 80 percent would be accounted for by companies with incomes under $100,000. If a larger revenue loss were permissible, a more substantial reduction in the normal tax, say to 22 percent with an equivalent increase in the surtax rate to, say, 30 percent would further increase the share of the total tax reduction accruing to the benefit of small companies. This rate structure, it is estimated, would cost between 350 to 400 million dollars in Government revenues.

Proponents of this revision in the corporate tax rate structure point out that it would serve to spread the differential in effective rates of tax between large and small corporations. At the same time, they maintain, it would avoid the "notch" difficulties inherent in a limited graduation system and would avoid or minimize the objections raised against full graduation of marginal rates.

On the other hand, critics of this approach point out that so long as the surtax exemption remains at $25,000, compensating adjustments in the normal and surtax rates would not significantly reduce the adverse impact of the high combined rate on quite modest amounts of income. They point out that even though the total amount of tax savings under the proposal which would go to small companies is large relative to the tax savings of large companies, the savings for many small companies would be quite limited.

The following table compares the tax savings which would be obtained at various levels of taxable income under a $100,000 surtax exemption and under a 22 percent normal tax rate with a 30 percent surtax rate.

Taxable income	Present law tax	$100,000 surtax exemption		22 percent normal tax, 30 percent surtax	
		Amount of tax	Reduction from present law	Amount of tax	Reduction from present law
$5,000	$1,500	$1,500		$1,100	$400
$10,000	3,000	3,000		2,200	800
$25,000	7,500	7,500		5,500	2,000
$50,000	20,500	15,000	$5,500	18,500	2,000
$100,000	46,500	30,000	16,500	44,500	2,000
$1,000,000	514,500	498,000	16,500	512,500	2,000
$10,000,000	5,194,500	5,178,000	16,500	5,192,500	2,000

(*b*) *Treatment of accumulated corporate earnings.*—The provisions of the Federal tax law dealing with accumulated corporate earnings are of major importance to small and new corporations since retained earnings are generally regarded as the primary source of the funds required to finance the development of such companies. These provisions of the law are also important in that they are intended to prevent the use of the corporate organization as a means of insulating personal income from the full impact of the individual income tax. The extent to which considerations of protecting the economic position of small and new businesses are in conflict with those for assuring an equitable distribution of individual income tax liabilities has been subject to review repeatedly since the first enactment of the income tax in 1913.

The provisions of the present law dealing with the taxation of corporate accumulations are found in chapter 1, subchapter G of the Internal Revenue Code of 1954. Of principal concern in the present connection are those found in sections 531 through 537, dealing with corporations improperly accumulating surplus. These sections provide for the imposition of an additional tax on corporate income where the corporation is formed or availed of for the purpose of avoiding the income tax of its shareholders by permitting earnings and profits to accumulate instead of being distributed. The tax is imposed at the rate of 27.5 percent of the corporation's accumulated taxable income not in excess of $100,000, plus 38.5 percent of such income over $100,000. Accumulated taxable income is defined as taxable income adjusted by taxes paid, charitable contributions, capital gains and losses, and dividend payments. A credit is allowed for the amount of the earnings and profits of the taxable year which are retained to meet the reasonable needs of the business. The minimum amount of this credit is $60,000 of accumulated earnings (from past and present earnings combined). Accordingly, this minimum credit is the amount by which $60,000 exceeds accumulated earnings and profits as of the end of the preceding year.

Imposition of the penalty tax is conditional upon proof by the Government of avoidance as the purpose for the accumulation. Accumulation in excess of the reasonable needs of the business, including anticipated needs, is determinative of an avoidance purpose, in the absence of conclusive proof to the contrary.

The present law involves several modifications of the provisions in the 1939 Revenue Code. Chief among these modifications are (1) the provision of a minimum $60,000 credit; (2) the imposition of the burden of proof upon the Government as to the reasonableness of the accumulations; and (3) the application of the tax to only that portion of the retained earnings deemed unreasonable, instead of to the entire amount of retentions.

Since the fundamental purpose of the accumulated earnings tax is to prevent use of the corporate organization to avoid individual tax liability, the problems arising under these provisions are associated primarily with private or closely held companies. Prior to the 1954 revisions, the most frequent complaint made against the tax was that its application was so uncertain as to create barriers to pursuing financial policies which most closely accorded with the business needs of such companies. It was frequently argued, for example, that dividend distributions were made in excess of those which could be afforded solely to prevent the possible application of the penalty tax. Because of the uncertainty regarding the standards employed by the Internal Revenue Service in determining applicability of the penalty provisions, it was alleged that closely held small and new businesses were inclined to strip themselves of the internal funds which they could put to profitable use. Moreover, the difficulties involved, once action was initiated by the Internal Revenue Service, in establishing the reasonableness of the accumulation hinged primarily on the taxpayer's ability to prove future needs.

The 1954 Revenue Code revisions in this area have largely eliminated these complaints. Proposals for additional specific exemptions or credits against the penalty tax may be anticipated as the new law goes into operation and new problems are uncovered.

On the other hand, opponents of the recently enacted provisions maintain that the effectiveness of the penalty provisions in preventing tax avoidance has been substantially reduced. In the context of the avoidance problem, it is argued that the basic difficulty stems from the lack of integration of individual and corporate income taxation in the case of the private or closely held company. Such corporations are distinguished from public companies in that the latter, because of the dispersion of stock ownership, are generally not subject to the control of any one taxpayer or small group of taxpayers, whereas in the former case the corporation in fact represents an income conduit for its owners, acting under their general direction. It is recognized that the 1939 Code provisions did not afford integration, but it is maintained that they did serve more effectively than the present law to prevent preferential tax treatment of small incorporated businesses, as compared with comparable unincorporated enterprises.

Critics of the present provisions also maintain that the growth-inhibiting effect of the previous provisions was greatly exaggerated. Thus, it is pointed out that relatively few actions were initiated by the Internal Revenue Service, and that the Service gave very liberal consideration to the taxpayer's position in determining whether the action was warranted.[19]

C. CORPORATE ORGANIZATIONS, REORGANIZATIONS AND LIQUIDATIONS

Since 1921 the Congress has followed a broad and uniform policy in enacting legislation designed specifically to facilitate the tax-free organization and financial readjustment of the corporate structure. The 1954 Code in general continues provisions of prior law which permit tax-free adjustments of the corporate financial structure including the organization and reorganization of the corporate entity. The revelant provisions of the taxing statute (designated popularly as the "Reorganizations Sections") provide relatively minute and detailed rules for a series of specified transactions which may be effectuated without tax hindrance. These include: (*a*) corporate organizations; (*b*) corporate recapitalizations and reorganizations; (*c*) corporate mer-

[19] A thorough and careful examination of the operation of the old sec. 102 provisions was made in 1952 by Dr. James K. Hall, professor of economics, University of Washington, for the Joint Committee on the Economic Report (The Taxation of Corporate Surplus Accumulations, 82d Cong., 2d sess.). Dr. Hall's report presents an objective statement of the background of the tax on corporate surplus accumulations, of the criteria employed in its application, of specific and general economic effects and of the administrative and judicial enforcement of the tax. Valuable statistical data showing the number and type of cases brought under the statutory provisions and the net revenue gain to the Government are presented in numerous tables. For a critical appraisal the new provisions, cf. Hall, "Provision of the Internal Revenue Code and sec. 102," National Tax Journal, vol. VIII, No. 3, September 1955, pp. 275-286.

gers and consolidations; (*d*) corporate separations; and (*e*) corporate liquidations. The generalized structure of the 1954 Code treatment of the foregoing transactions is as follows:

1. Corporate organizations

A person (or persons) may form a corporation without immediate tax by transferring property to the newly organized corporation and receiving in exchange stock in such corporation. Provided the person (or persons) transferring the property owns 80 percent of the stock of the newly organized company, no tax is payable at the time of incorporation. This provision provides the vehicle under which the typical sole proprietorship or partnership is incorporated.

2. Corporate reorganizations—recapitalizations and reincorporations

A corporation may, without any immediate tax consequences, readjust its financial structure through a recapitalization. Typical tax-free recapitalizations include the exchange of existing preferred stock for new common stock, of one class of common for another class of common, of existing bonds for new bonds. Similarly a corporation may change the State of its incorporation, change its name, etc., without tax effects. In each of the foregoing instances, it is necessary that a business purpose germane to the conduct of the corporate enterprise form the basis for the desired transaction. If no business purpose underlies the transaction, and it in fact masked a device by which a disguised dividend is declared, both the court and the statute are free under prescribed circumstances to treat the transaction in accordance with its true nature. For example, the exchange of existing common stock for new common stock and bonds would be treated, to the extent of the fair market value of the bonds, as the distribution of a corporate dividend, since the shareholders control the corporation before and after the transaction. Similarly the distribution of a preferred stock dividend or the emergence of preferred stock in a recapitalization, together with a sale of such preferred, i. e., the so-called preferred stock bailout is taxed as if the corporation in substance had declared a dividend to its shareholders.

3. Corporate reorganizations—mergers and consolidations

Specific provisions of the taxing statutes provide for the tax-free amalgamation of two or more corporate enterprises. Mechanically, the law permits shareholders of one corporation as part of a statutory merger or other corporate acquisition to exchange their shares for shares of a new corporation which has acquired the assets of stock of the corporation of which they were shareholders. Similarly two corporations may consolidate by pooling their assets and issuing to shareholders of both of the old corporations, stock and securities of the newly organized consolidated corporation. From the corporation's standpoint, mergers and consolidations are effective under the merger and consolidation laws of a State, through the acquisition of the assets of one corporation and the exchange of stock or securities of the acquiring corporation, or through the acquisition of stock of one corporation and the issuance and exchange therefor of stock of the acquiring corporation.

In order to assure that the foregoing transactions are treated in a tax-free manner, two unwritten judicially imposed requirements must be met:

(1) The transaction must have a business purpose as its basis; and

(2) The shareholders of the corporation which disappeared by reason of the merger or consolidation must have a continuity of interest in the corporation which survives.

The so-called continuity of interest test has been superimposed upon the reorganization pattern by the courts in order to insure that a purchase and sale of corporate assets will not be disguised in the form of a corporate reorganization. Thus, if all of the shareholders of a corporation exchange their stock for bonds of the acquiring company, without any stocks, the continuity of interest requirement will not have been satisfied. In that situation, no equity ownership in a surviving corporation remains in the prior shareholders. In effect, they have "sold" their interest to the new company. Under these circumstances, tax is imposed at the time of the exchange.

4. Reorganizations—corporate separations

It is also possible, under the specific provisions of the taxing statute to divide a corporation into two or more of its functioning economic components without any immediate tax effects. For example, a corporation engaged in the manufacture of two products, both of which are sold to the public, may separate into two corporations by incorporating one of the branches of its business and distributing the stock of the newly formed corporation to its shareholders. Similarly, a corporation which owns a subsidiary engaged in a line of business with the general public may distribute the stock of that subsidiary to its shareholders.

In order to accomplish a tax-free corporate separation, a multitude of complex statutory requirements must be met, involving the nature of the businesses, the manner of stock distribution, etc. In this area, the law permits under certain circumstances the division of existing corporations through the divestiture of their subsidiaries or businesses for bona fide corporate reasons. A consequence of such a transaction results in removal of corporate earnings at the capital gains rate through the distribution of stock and later sale of that stock. The area of corporate separations, i. e., spin-offs, split-offs, and split-ups is one of the most difficult in all of the reorganization sections.

5. Corporate liquidations

The tax statute also provides special rules governing the termination of the corporate enterprise through the device of a corporate liquidation. Unlike the corporate organization and reorganization provisions, these rules provide for taxation to the shareholder at the time of liquidation. Thus, when the shareholder surrenders his shares for cancellation or retirement, and receives corporate assets in exchange, taxes are payable at capital gains rates, generally measured by the difference between the value of the assets received by the shareholders and the cost to him of the stock surrendered. Other special rules, however, provide for tax-free corporate liquidations in limited circumstances where there are no corporate accumulated earnings and profits and where one corporation as parent, liquidates its subsidiary under prescribed circumstances. The purpose of these provisions is to permit the simplification of the corporate structure by permitting the tax-free liquidation of a subsidiary into its parent.

The foregoing rules were first stated in elaborated form in the statute in 1934. From that period until 1954 a series of technical difficulties developed in the application of the sections and in the tax avoidance possibilities presented by their use. In the technical area, tax practitioners have been concerned with correlating the tax treatment of stock dividends and corporate recapitalization, with eliminating the so-called proportionate interest requirement in connection with corporate organizations, with facilitating corporate mergers where it is desired to place the assets of the acquired company in a subsidiary of the acquiring corporation, with more flexible rules for corporate separations, with assurances that no double tax would be imposed upon the sale of a corporate business, and with facilitating the acquisition by a corporate purchaser of a cost basis equal to the purchase price in stock. From the Government's standpoint, there has been great concern in the 20 years between 1934 and 1954 with the possibilities of abuse of the corporate reorganization and distribution provisions through the device of the "preferred stock bailout," of the sale of stock of a collapsible corporation, and of the possibilities for transmuting the corporate separation provisions into devices for dividend distributions.

In the realm of tax policies there is general agreement that the tax-free aspects of corporate organization, mergers and consolidations and separation should be continued. Some concern was had that sales of corporate stock were being effected through the device of a merger in situations where a small closely held family corporation was merged into a large publicly held company. In such case, the family shareholders of the disappearing corporation received only a fractional amount of the stock of the surviving entity, which could be held until death. In such case the increment in value would escape income-tax entirely. By reason of this the original version of the 1954 code, in the form passed by the House of Representatives, would have prohibited tax-free mergers unless the disappearing company was at least one-fourth the size of the acquiring company. This provision met with disapproval on the part of the bar and the business community and was deleted from the 1954 code in final form.

Some attention was also given to the question of special tax treatment for closely held corporations. It was suggested that such a corporation is in reality an entirely different form of organization, and the large management-control companies should be treated differently for tax purposes. For these reasons, certain of the merger restrictions incorporated in the House version of the 1954 code did not apply to so-called publicly held corporations. Again, disapproval was raised on the theory that the Congress was discriminating between the large and small companies. No such discrimination appears to have been intended; the proposed revision was based on the general impression that the use of the corporate form as a device for disguised dividend distribution was prevalent in small, closely held corporations and not at all a part of the pattern of the business operation of the larger enterprises.

The trends which are now discernible in the intercorporate transaction field seem to foster mergers between two large corporations or between a small one and a large acquiring entity. In the former case the opportunities for combined efficiency, larger sales output, etc., spark the original desire for the merger; the tax law facilitates the merger by providing tax-free treatment. The opportunity to merge tax-free a small family corporation into a larger concern, gives the businessman his chance to retire from business and to postpone tax upon the appreciation in value of his private corporation until he decides to sell in whole or in part the stock so acquired by reason of the merger or the opportunity to recover the appreciation tax-free by holding the stock until his death.

Although in recent years, larger corporations have tended to amalgamate through mergers, in the case of smaller closely held organizations, a tendency is discernible toward division of the corporate enterprise through the separate incorporation of various functions of the family corporation. Typical of such transactions prior to the 1954 code were the incorporation of the real estate on which the family business was conducted, or if the business were carried on at several locations, the separate incorporation of each of the locations. The 1954 code changes respecting corporate separations in some respects made more difficult the opportunity to divide an existing business. Thus, the real estate on which the company conducts its activities may not be separately incorporated unless a substantial portion thereof is rented to outside persons. Various operating divisions of a corporation may not be separately incorporated unless each of the divisions, in fact produces taxable income on its own account. On the other hand, the various conditions provided in the statute can in many instances be fully satisfied. Accordingly, the shareholders can continue to divide their stockholdings into two or more corporations in order to make their stock more readily marketable or more readily distributable to members of the family, or in order to provide additional corporate surtax exemptions for the enterprise or related enterprises.

TAXATION OF INCOME FROM FOREIGN SOURCES

I. Present Law

The increasing interest in recent years in expanding and strengthening the economy of the free world has focused attention on the use of public policy to encourage private investment abroad. Considerable discussion has centered around the use of tax devices to provide incentives for such investment or to overcome special risks which are claimed to attend private investment by United States citizens in some foreign areas.

The present tax law contains no generally applicable provisions intended to stimulate private foreign investment. Special provisions are made, however, to provide relatively favorable tax treatment in certain specific cases. Much of the current discussion about the use of tax policy to provide incentives for expanding investment abroad concerns the desirability of extending these special provisions to other areas.

Under the present law United States citizens and domestic corporations are subject to the Federal income tax on their entire incomes regardless of where this income is earned. In view of the fact that the income taxes of most countries apply to all income derived within their jurisdictions, this feature of the United States law would result in substantial double taxation of citizens doing business abroad were it not for basic provisions in the law designed to mitigate this double tax burden. Thus, some double taxation is eliminated by specific treaties, to a number of which the United States is a party. In addition, the Federal income-tax law includes several statutory provisions which provide adjustments in Federal income-tax liabilities. These include (*a*) the deduction for foreign taxes paid, (*b*) the credit for foreign taxes paid, (*c*) special tax rate reductions for Western Hemisphere trade corporations and China Trade Act corporations. In addition, special tax treatment is provided with respect to earned income of United States citizens working abroad and income earned by United States citizens and corporations operating in United States possessions.

A. FOREIGN TAX CREDIT OR DEDUCTION

In determining their United States tax liability, American citizens or corporations subjected to foreign income taxes may either—

(a) Deduct from their gross income the full amount of foreign taxes paid;[1] or

(b) Take a credit against United States income tax for income, war profits, or excess profits tax (or other taxes in lieu of such taxes) paid to a foreign country or to any possessions of the United States. The amount of such credit with respect to any one country cannot exceed that proportion of the United States tax which the taxpayer's income from sources within such country bears to

[1] I. R. C., sec. 164 (a), (b) (6).

his entire taxable income.[2] The credit tends to limit the combined foreign and United States income taxes to the level of the Federal income tax.

The law also makes provision for a proportional credit for the taxes paid by a foreign corporation in which an American corporation owns at least 10 percent of the voting stock.[3] Credit may also be obtained on account of the taxes paid by a foreign subsidiary of such foreign corporation where the latter holds 50 percent of the voting stock of the former.[4]

In the case of a company with a foreign subsidiary corporation, the United States tax liability, as adjusted by the foreign tax credit or deduction, accrues only when the subsidiary income is remitted to the domestic parent company. On the other hand, a United States company operating abroad through a branch or through a domestic subsidiary is currently taxable with respect to its share of the foreign income, regardless of when such income is returned to the United States.

Taxes have always been recognized as a legitimate deduction in computing taxable income, but it was not until 1918 that the alternative of a credit was first given. Until 1921, the credit was allowed dollar for dollar, but the 1921 Revenue Act provided that the total credit might not exceed that proportion of the United States tax which the income from without the United States bore to total income. In 1932, Congress enacted a per country limitation in addition to this overall limitation. In other words, the credit for taxes paid to any one country (as well as all countries together) might not exceed that proportion which the income earned within such country bore to total income. This per country limitation still continues in the law, although the overall limitation was eliminated in the rewriting of Internal Revenue Code of 1954.

The 1918 act also permitted a domestic corporation to claim a proportional credit for taxes paid by its foreign subsidiary, if the domestic company held a majority of the stock of the subsidiary. This was reduced to a 10 percent holding requirement in 1951. The provision for a credit on account of the taxes paid by a foreign subsidiary of a foreign subsidiary was added in 1942. As first enacted, there had to be 100 percent ownership of the stock of the second subsidiary; this was reduced to 50 percent ownership in 1951.

The foreign tax credit is also now available to shareholders in certain investment companies which hold foreign securities. The law had exempted regulated investment companies from the income tax on the theory that they are mere conduits, and should be taxed only on their undistributed income. The prior law allowing a credit for foreign taxes, however, was of little value to these companies because they were only taxed on such undistributed income. The 1954 Internal Revenue Code allows the foreign tax credit to be passed through to the shareholders of the regulated investment company, provided more than 50 percent of its assets is invested in foreign securities.[5]

B. WESTERN HEMISPHERE TRADE CORPORATIONS [6]

A special rate reduction of 14 percentage points is granted to so-called Western Hemisphere trade corporations. Such corporations

[2] I. R. C., secs. 901, 903, 904.
[3] I. R. C., sec. 902 (a).
[4] I. R. C., sec. 902 (b).
[5] I. R. C., sec. 853.
[6] I. R. C., secs. 921–922.

are defined by the law as United States corporations all of whose business is done in North, South, or Central America, or the West Indies. To qualify they must satisfy the following requirements:

(a) 95 percent of their gross income must be derived from sources outside the United States; and

(b) 90 percent of their gross income must be derived from active conduct of a trade or business.

If a Western Hemisphere trade corporation is a subsidiary of another American corporation, dividends received by the latter are subject to the regular tax on dividends received, i. e., 52 percent on 15 percent of such dividends. The Western Hemisphere trade corporation may credit its foreign taxes against its United States tax.

This special treatment for Western Hemisphere trade corporations was first granted in 1942 to alleviate the alleged competitive disadvantage under which it was claimed American firms were doing business in the other Americas. It was pointed out that the disadvantage became especially great by reason of the new wartime rates imposed by the United States on its corporations wherever operating, while other countries often completely exempted the foreign income of their corporations.

C. CHINA TRADE ACT CORPORATIONS [7]

Corporations organized under the China Trade Act of 1922 are allowed a special deduction in computing their taxable income. The deduction is determined as that proportion of the taxable income derived from sources within Formosa and Hong Kong which the par value of stock owned by persons resident in Formosa, Hong Kong, the United States or its possessions, and individual citizens of the United States, bears to the total value of all outstanding stock. The deduction is available only to the extent of a special dividend distributed to such persons in addition to all other amounts payable by reason of their interest in the corporation. The deduction now allowed was formerly in the form of a credit and had application to China in general rather than the limited area indicated above. Changes were made in the law during 1954 to give effect to the changed international situation in the Far East. Residents of Formosa and Hong Kong are permitted to exclude from gross income dividends received from China Trade Act corporations. The law originally enacted in 1922 was designed to stimulate foreign trade in that area.

D. EARNED INCOME OF UNITED STATES CITIZENS ABROAD [8]

United States citizens living abroad may exclude the compensation they receive on account of services performed abroad, other than compensation paid by the United States, under either of the following conditions:

(a) Bona fide residence abroad for an uninterrupted period which includes an entire taxable year; or

(b) Physical presence abroad for at least 510 days during a period of 18 consecutive months. The exclusion in this case may not exceed $20,000 for any one taxable year.

The first of the foregoing provisions applicable to bona fide residents abroad was originally granted in 1926 as a step toward increas-

[7] I. R. C., sec. 941-943.
[8] I. R. C., secs. 911-912.

ing our foreign trade. The second provision was added in 1951 in order to relax the bona fide residence requirement of the earlier provision and provide an incentive to American technicians to go abroad under the point 4 program. The 1951 amendment however was so worded that many persons not intended to be covered (e. g., movie actors) were able to take advantage of it; a 1953 amendment limiting the exemption to $20,000 corrected much of the alleged abuse.

E. INCOME WITHIN UNITED STATES POSSESSION [9]

A United States citizen or domestic corporation may exclude from his gross income any income, including salary (other than from the U. S. Government), derived from sources within a possession of the United States, if he can show that within a period of 3 years immediately preceding the close of the taxable year:

(*a*) 80 percent of gross income for such a period was derived from sources within a possession; and

(*b*) 50 percent of gross income for such a period was derived from the active conduct of a trade or business within the possession.

For purposes of the foregoing, "possession" does not include the Virgin Islands, and when used with respect to citizens of the United States does not include Puerto Rico.

II. Issues and Proposals

The basic issue in the current controversy over the taxation of income derived abroad is the extent to which tax devices can be used to promote private foreign investment and the type of tax device which would most effectively serve this purpose. The issue is complicated by equity considerations which would tend to oppose the imposition of preferentially lower tax burdens on foreign income.

A. BARRIERS TO FOREIGN INVESTMENT

Whether or not tax policy can be used to promote foreign investment depends on the character of the barriers to such investment in the current situation. These may be described briefly as follows:

1. Comparative profitability of domestic as opposed to foreign investment

An important factor contributing to the limited expansion of private foreign investment in the postwar years has been the high levels of economic activity in the United States and the consequent expansion of domestic investment opportunities. As a general rule, a growing business enterprise will not direct its investable resources abroad unless it anticipates that the net returns on such investments, allowing for any extra risk that may be involved, will at least equal, if not exceed, those it may obtain from domestic investment. Exception to this rule will ordinarily be made when such foreign investment is essential to continuing expansion of domestic operations, as in the case of assuring an adequate supply of the raw materials required. In general, however, it may be assumed foreign investment has been deterred by the extraordinary rate of growth in the United States

[9] I. R. C., sec. 931.

economy since the end of World War II, particularly since a major contributing factor in this growth has been a rapid rate of technological development requiring substantial commitments of investment funds.

2. Hazards in foreign operations

In the unsettled international conditions which have characterized the postwar period, the risks of foreign business operations have loomed large as a deterrent to foreign investment. The ever-present dangers of war, nationalization or expropriation of alien properties, political instability, social unrest, discriminatory application of restrictive laws, and currency and exchange controls have served to magnify the risks of foreign ventures. Recognition of such risks results in a significantly higher rate of discounting the prospective return on a given investment and may often result in foregoing what might otherwise be regarded as a profitable opportunity.

3. Lack of information concerning investment opportunities

According to some authorities, one of the major factors responsible for the failure of private foreign investment to expand as desired is the general lack of knowledge of the existence of foreign investment opportunities. This appears to be particularly true in the case of small and medium-sized companies. The lack of direct business contacts probably is largely responsible for continuing ignorance of business opportunities as well as misapprehensions with respect to the conditions under which investments may be profitably made.

4. Tax considerations

The present tax treatment of foreign earnings is often cited as one of the principal barriers to private foreign investment. In the first place, it is claimed that the Federal income tax does not make adequate provision for the extraordinary risks which often are associated with doing business abroad. Secondly, it is argued that American firms doing business in a foreign country with low tax rates are at a disadvantage as compared with domestic companies in that country and with foreign firms from countries imposing lower tax rates. This results from the fact that the United States taxes income from foreign sources to the extent that it is not taxed abroad. In fact, it is argued, this treatment may even encourage foreign countries in which American capital is already in place to increase their taxes on business income. Finally, it is pointed out that in any case the foreign country cannot use favorable tax rates as an incentive device.

The relative importance of each of these barriers may be presumed to vary considerably from one company to another and from one foreign area to another. One recent study concludes that tax considerations are the least important of those taken into account in appraising foreign ventures and in fact are often neglected entirely. However that may be, it is possible that tax devices could be formulated to arouse greater interest in foreign investment opportunities, to provide special offsets to the risks inherent in foreign investment, or to make the prospective net return from such activity sufficiently attractive relative to those from domestic investment programs as to induce a shift in the allocation of investable resources.

B. OPPOSITION TO PREFERENTIAL TAX TREATMENT OF FOREIGN INCOME

Whether or not such devices are adopted, it is maintained, should depend on the extent to which they conform with generally accepted standards as to effective resource allocation and fairness among taxpayers.

1. Equity arguments

The principal equity argument offered against special tax treatment for income derived abroad is that the source of the income is not relevant in determining the taxpayer's capacity to meet his obligations to the Federal Government. Accordingly, it is argued, equal amounts of net income should bear equal Federal income tax burdens, regardless of where the income arises. According to this view, special inducements may very well be necessary to overcome the hazards peculiar to foreign investment, but these provisions should not take the form of preferential tax treatment of the income derived from such investments.

Moreover, it is maintained that it would be virtually impossible under most of the tax proposals offered to prevent preferential treatment from being accorded to income from existing investments. Such preferential treatment would be completely unwarranted in the light of its objective and would require a shift in tax burden to other sectors of the domestic economy.

Finally, it is argued that tax concessions for income derived abroad would principally benefit large companies and high-income individuals and thus worsen the distribution of tax burdens. Small companies, it is pointed out, very rarely undertake foreign capital commitments since they do not have adequate resources to permit the diversification of activity such commitments involve. Accordingly, it is argued that extending tax benefits to foreign investment would simply enhance the position of large companies in the Nation's business structure at the expense of the smaller companies.

2. Economic arguments

The principal economic argument offered against preferential tax treatment of foreign income is that public policy should not seek to distort the allocation of investable resources resulting from the action of basic market factors. Thus, it is maintained that in the absence of a discriminatory tax burden on foreign income, the extent to which available resources are committed to foreign ventures will depend on the comparative net returns from foreign and domestic investments. Preferential tax treatment of foreign income, by enhancing the net returns from foreign investment, will undoubtedly serve to shift resources abroad but at the expense of less efficient resource use overall. Accordingly, it is maintained, revision of the taxation of income derived abroad should be limited to providing neutrality as between domestic and foreign income.

Proponents of this view hold that the only significant way in which the present tax law may be biased against income derived abroad is in providing inadequate allowances for the special risks which may be involved. The principal feature of the law in this connection is the net operating loss deduction and carryover, which at present provides an 8-year period for offsetting business losses against income. This is held to be an adequate offset provision for any but the most extraordinary of risks which could be reasonably assumed. Special treatment of gains and losses realized as a result of involuntary conversions are also thought to provide additional risk insurance.

C. SUPPORT FOR PREFERENTIAL TREATMENT OF FOREIGN INCOME

The major argument offered in support of virtually all of the proposals for preferential tax treatment of incomes derived abroad is that the objective of stimulating foreign investment is so important in the present state of international affairs as to outweigh opposing considerations. The success of American political policy in fortifying underdeveloped countries of the free world against the inroads of communism is held to depend, at least in part, on strengthening their national economies. This requires a substantial increase in capital formation in those areas, to which the United States must devote some of its resources. These resources will be more effectively utilized, it is maintained, if directed abroad under private auspices—i. e., subject to private managerial decisions—than under those of the Federal Government. According to this view, therefore, tax concessions to stimulate private foreign investment will result in the best possible allocation of investable resources, so long as public policy is committed to overseas economic assistance.

Proponents of more favorable tax treatment of foreign income also claim that the alleged revenue loss and redistribution of tax burden is significantly overstated. If tax concessions are successful in providing the desired flow of private investment funds, the Federal Government will be relieved substantially of its foreign economic assistance obligations, permitting a general reduction in tax revenues which may be provided so as to adjust tax burdens in whatever way is generally regarded as most desirable.

Furthermore, it is pointed out, the real cost of expanding foreign investment is not properly measured in tax dollars but in terms of the resources committed for use outside the United States. Measured in these terms, the cost of assisting in foreign economic development will be minimized if the vehicle of private foreign investment is employed.

On equity grounds it is maintained that the income tax should bear less heavily on income derived abroad than on domestic income. Economic activity abroad, it is alleged, is carried on without many of the benefits accorded to domestic business operation. Similarly, such activity involves less demand on Federal Government resources. Tax contributions, it is argued, should at least roughly reflect this differential.

D. MAJOR PROPOSALS FOR REVISING THE TAX TREATMENT OF INCOME DERIVED ABROAD

1. Complete exemption of foreign income

Complete exemption of income earned abroad has been recommended as the most effective way to encourage private foreign investment. It would permit foreign countries needing capital to offer the utmost in incentives through no income tax or a very low rate, and eliminate the divergence in treating income from branches versus foreign subsidiaries. In addition, it is argued that since foreign investments fall under the jurisdiction of the foreign country, the income derived is not accorded the full benefit of the services and protection which the United States Government provides for investments at home.[10]

Objection to this proposal is raised on the ground that, though the income may be earned abroad, a United States company operating abroad receives United States Government services and protection for which a tax may rightfully be exacted. Furthermore, complete exemption might be too successful and induce American firms to remove their home productive facilities outside the country while retaining the United States market; this could perhaps be prevented by denying the exemption if more than a specified percentage of the firm's foreign product were sold in the United States.

2. Rate reduction

A somewhat less extreme proposal is for the taxation of business income from foreign subsidiaries or branches at a rate 14 percentage points lower than the corporate rate on domestic income.

This proposal was given favorable consideration by the House Ways and Means Committee in its report on H. R. 8300, the Internal Revenue Code of 1954.[11] However, at the Senate Finance Committee hearings, numerous objections were raised by business spokesmen to the phraseology and limitations of the provision as drafted by the House, with the result that the Senate Finance Committee struck it out.[12] The Finance Committee felt that this was new ground which presented uncertainties and difficult problems. The committee stated that it was itself exploring various alternative approaches but had been unable to find a solution that was satisfactory. It, therefore, omitted the provision from the bill with the thought that in conference an answer could be found. However, none was found, and the rate reduction was omitted.

One of the problems of eliminating the tax on foreign income or giving reduced rates on income earned abroad is determining where the income is actually earned. What weight should be given to the place of manufacture, the place where the contract is entered into, the place of sale, the place where title passes, etc.? How should interest, dividends, rents, royalties, etc., be treated? Should the tax concession be available with respect to all types of business activities or only those requiring substantial capital outlays?

3. The foreign business corporation approach

An entirely new approach to the taxation of foreign income has been proposed as essential to effective stimulation of foreign investment. Under this new approach a special class of American corporations would be established for tax purposes. These foreign business corporations would be designed to be the vehicle for all foreign operations and would be permitted to engage in export and to operate abroad directly or through foreign subsidiaries. United States taxes would be imposed on the income of a foreign business corporation in the same manner as any other domestic corporation. However, the

[10] August Maffry, Program for Increasing Private Investment in Foreign Countries, December 18, 1952, pp. 34–35 (mimeographed). Paul D. Seghers, Hearings before the Senate Committee on Finance on the Internal Revenue Code of 1954, p. 893. Committee on Taxation of the United States Council of the International Chamber of Commerce, Hearings before the Senate Committee on Finance on the Internal Revenue Code of 1954, p. 2145.

[11] H. Rept. 1337, pp. 74–76, A254–A258.

[12] S. Rept. 1622, p. 105.

payment of the tax due on the income would be deferred until that income was distributed directly or indirectly to its shareholders or used in the United States other than for foreign operations. A foreign business corporation could invest its funds in bank accounts here and in United States Government bonds.[13]

The particular merits ascribed to this proposal is that it would limit preferential tax treatment to companies committing capital abroad only to the extent that they reinvested the earnings from their foreign investments outside the United States. Full United States tax liability would accrue when these were withdrawn from abroad. Accordingly, so long as the income were used abroad, it would be subject only to whatever tax treatment, favorable or otherwise, was afforded in the foreign jurisdiction.

4. 5-year amortization

Five-year amortization of foreign assets is sometimes proposed as a device for stimulating foreign investment.[14] The argument offered in support of a proposal such as this is that it has advantages over most of the other available and proposed concessions. These latter, it is contended, relate only to profits and dividends earned after the investment is made and has been operating for some time, whereas what is needed is something to reduce the risk of loss of capital (war, confiscation, nationalization, etc.) which is the initial and decisive deterrent to foreign investment. It is argued that if investors could see a possibility of getting their capital back in 5 years (often through deductions against other projects), they would be more inclined to make investments.

On the other hand, it is pointed out that the benefits of the proposal would be limited to investors in depreciable facilities. Other types of foreign business activity, particularly technical service companies, however, warrant at least equal encouragement.

5. Tax credits

A number of proposals have been made for revision of the foreign tax credit. Most of these pertain to specific limitations on the effectiveness of the credit under special circumstances.

When the foreign income taxes imposed on American business abroad are less than the corresponding United States taxes, the American firm pays a combined tax equal to that which it would pay if the income had all been earned at home. This is true because after applying United States rates to the entire income, the foreign tax is credited against the United States tax. If the taxes paid abroad equal or exceed the United States tax, the credit has the effect of completely eliminating the United States tax on the foreign earned income. Substantial equality thus generally prevails in the taxation of income from domestic and foreign sources. Only when taxes of the foreign country on income earned therein by American firms exceed United States rates is the total United States and foreign tax in excess of what the United States burden would be if all the income had been earned at home.

(*a*) *Types of tax for which credit is allowed.*—One complaint against the present foreign tax credit is that it is limited to taxes on income,

[13] E. R. Barlow and Ira T. Wender, Hearings before the Senate Committee on Finance on the Internal Revenue Code of 1954, p. 1723.

[14] M. C. Conick, Stimulating Private Investment Abroad, Harvard Business Review, November–December 1953, p. 104.

war profits and excess profits taxes, or taxes in lieu of income taxes. Because some countries place major stress on sales, production, or export taxes, rather than income taxes, it has been proposed to broaden the interpretation and liberalize the types of taxes for which a credit may be obtained. The Ways and Means Committee, for example, proposed in 1954 [15] to allow a credit for a "principal tax" imposed by a national government instead of the taxes based on income. Objections were raised to this new concept.[16] The Senate Finance Committee, however, rejected the change on the ground that in many instances it would reduce the amount of credit available and would lead to many difficult interpretative problems.[17]

(b) *Per country limitation.*—It is generally recognized that either a per country limitation or an overall limitation is needed to protect United States revenue. The overall limitation was repealed by the Internal Revenue Code of 1954. One of the difficulties found with the per country limitation is that no credit is allowed for that part of the income tax of a foreign country which is proportionately greater than the United States tax. Due to differences in accounting and reporting principles, income which may enter into the tax computations of the United States in one year may not enter the tax computations of another country in an earlier or later year. Because of this disparity in timing, it is proposed that any excess of taxes paid or accrued to any foreign country for any year over the amount allowable as a credit be carried back to the 2 preceding years and then carried forward to the 5 succeeding years. Such a proposal passed the House of Representatives in July 1955.[18] Further, the United States corporation may receive dividends from its subsidiaries during a year in which net losses are sustained and thus lose the benefit of the tax credit; to correct this it is urged that the tax credit also be a carryback or carryover, as the case may be, to the same year as the operating loss carryback or carryover relates.[19]

Repeal of the per country limitation would be beneficial to a relatively small number of corporations where the foreign tax exceeds the United States tax, but this would result in a partial elimination of the tax on domestic sources of revenue. Such repeal might be an open invitation to certain countries to increase their own rates on profits from United States investments thus leading indirectly to a United States subsidization of such countries at the expense of lowered domestic revenues.

It has also been proposed that both the per country and overall limitations be retained in the law, with an option for the taxpayer to elect under which his foreign tax credit is to be limited.

6. Deferral of tax on branch income

One of the major complaints against the operation of the present tax law is that tax must now be paid currently on the income of foreign branches or domestic subsidiaries abroad, even though the

[15] Internal Revenue Code of 1954 (H. Rept. 1337), pp. 76–77.

[16] National Foreign Trade Council, hearings before the Senate Committee on Finance on the Internal Revenue Code of 1954, pp. 858–859, 870–872. Chamber of Commerce of the United States, the same, p. 1965. Committee on taxation of the United States Council of the International Chamber of Commerce, the same, p. 2145.

[17] Internal Revenue Code of 1954 (S. Rept. 1622), pp. 104–105.

[18] H. R. 6728 passed the House of Representatives on July 25, 1955, and was referred to Senate Finance Committee.

[19] Detroit Board of Commerce (Federal Taxation Committee). Hearings before the Senate Committee on Finance on the Internal Revenue Code of 1954, pp. 2180–2181.

profits are not (and perhaps cannot) be remitted to the United States. If a deferral is desired, it is necessary to operate through a foreign incorporated subsidiary.

One proposal for correcting this difficulty is the foreign business corporation, discussed above. Less drastic is the proposal that taxpayers have the right to elect that income of a foreign branch should not be taxed until it is returned to the United States.[20] This in effect would make branches taxable in substantially the same way as foreign subsidiaries. It would permit reinvestment abroad of branch profits without United States tax liability.

It is also sometimes proposed that, if requested, a corporation investing in a foreign subsidiary should be allowed to have the same treatment as is presently accorded a foreign branch.[21] The advantage of this latter choice would be to gain certain loss and depletion privileges now available to foreign branches.

The Internal Revenue Code revision as it passed the House of Representatives in 1954 granted domestic corporations an election to defer taxes on profits of their foreign branches similar to the manner in which taxes are deferred on the profits of foreign subsidiaries. Transactions between the home office and the foreign branch, if such an election were made, would have to be treated as transactions between two separate entities. Numerous objections were raised in the Senate hearings on the proposed code because of its restricted application. The Senate Finance Committee finally rejected it because of its being tied in with the 14-percent tax differential on foreign income, which the committee felt it had to reject because of the inadequate exploration of the new ground covered and the uncertainties and difficult problems raised. It should be noted, too, that there was a considerable lack of enthusiasm on the part of business for the proposal made by the Ways and Means Committee. A United States Chamber of Commerce study said:[22]

> * * * The suggestion to defer United States taxes on foreign branch earnings, while sound, might be of only limited usefulness. Its result would be more to add benefits to present foreign branch investors than to stimulate new foreign investment.

[20] Message of President Eisenhower on Foreign Economic Policy, Daily Congressional Record, January 10, 1955, p. 161. Commission on Foreign Economic Policy, Report to the President and the Congress, January 1954, pp. 21–22. Committee for Economic Development, Federal Tax Issues in 1955, p. 10. Chamber of Commerce of the United States (Foreign Commerce Department), United States Tax Incentives for Private Foreign Investment (January 1954), pp. 56, 60.

[21] Commission on Foreign Economic Policy, Report to the President and the Congress, January 1954, pp. 21–22.

[22] Chamber of Commerce of the United States (Foreign Commerce Department), United States Tax Incentives for Private Foreign Investment, January 1954, p. 59.

RETIREMENT PLANS AND DEFERRED COMPENSATION

In recent years there has been a very rapid growth in private pension, profit-sharing, and stock-bonus plans and in a wide variety of deferred compensation arrangements for employees. In part, the impetus for the growth of these plans has been the recognition of benefits to be obtained in improved personnel relations from provision for postemployment security. In part, the development has reflected the impact of the relatively high level of corporate and individual income-tax rates and the interest by the beneficiaries of the plans in providing for tax-deferred savings.

As a result of the growth of these plans and their tax treatment, a number of important issues have arisen. Chief among these are the significance of the volume and allocation of personal savings under these plans and their impact on personal savings and investment patterns, their effect on employee mobility, and the relationship of the special tax provisions applicable to these plans to the tax treatment of retirement income in general.

I. Present Law

A. PENSIONS, PROFIT-SHARING AND STOCK-BONUS PLANS

1. Description of plans

Under these plans, an employer makes regular contributions on behalf of covered employees to be set aside in a trust or used to pay premiums to an insurance company which assumes the obligation of meeting benefit payments to employees as they fall due. Frequently these contributions may be supplemented by contributions from participating employees. Generally, benefits are paid upon fulfillment by employees of certain specified conditions, such as reaching a designated retirement age, achieving a specified number of years of service, etc.

Pension plans may be distinguished from profit-sharing and stock-bonus plans in that pension contributions and benefits are generally measured by and based on such factors as years of service and compensation received by covered employees. Under profit-sharing plans the size of benefits depends on the employer's profits, either current or accumulated. Stock-bonus plans provide benefits similar to profit-sharing arrangements, except that payments are made in stock of the employing company and may be made out of capital rather than profits. There appears to be a tendency, currently, to mix the respective features of these plans in employee retirement programs.

Retirement plans usually provide definite and predetermined formulas for determining contributions and benefits. Usually, contributions to such plans are funded either in trusts, group annuities, or individual contracts. Trusteed plans involve the creation or designation of a trust organization to receive and manage contributions and to make benefit payments when due. Group annuity plans

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generally operate without the intercession of a trustee; the employer pays to an insurance company the premiums necessary to cover the full cost of a unit of annuity benefit on behalf of all covered employees taken together. Individual contract plans involve the employer's purchasing from an insurance company on behalf of each employee either an annuity contract or a retirement income contract, which combines the features of life insurance and annuity.

2. Tax treatment

Broadly speaking, the tax treatment of these various types of retirement programs is identical. The nature of the plan, whether pension, profit-sharing, or stock-bonus, and the means of financing benefits generally involve only minor differences in taxation.

(*a*) *The trust.*—The income of a trust forming part of a pension, profit-sharing, or stock-bonus plan of an employer for the exclusive benefit of his employees or their beneficiaries is not taxable if the plan meets the following conditions: (1) The plan must be permanent; (2) distributions of benefits under the plan must be on the basis of some predetermined formula; (3) the principal or income from the funds cannot be used for any purpose other than distribution to employees until all commitments to employees and their beneficiaries have been met; (4) the plan must benefit either (*a*) 70 percent of all the employees or 80 percent of all eligible employees provided not less than 70 percent of all employees are eligible, or (*b*) all employees within a classification which does not discriminate in favor of certain highly paid employees; (5) contributions and benefits under the plan must not discriminate in favor of highly paid employees.[1]

(*b*) *The employee.*—Employees participating in a qualified retirement plan do not include in their current taxable income amounts representing their employers' contributions to such plans. Tax liability results only when benefits are distributed.[2] Employees may not deduct their own contributions to the plan.

Benefits paid as an annuity are in general included in the employee's taxable income on the basis of the life-expectancy rule for the taxation of annuities. Under this rule, a portion of each annuity receipt is excluded from the recipient's income, the remainder being fully taxable. The excluded portion is determined by applying to the amount of each annuity payment the ratio of the amount paid for the annuity to the total amount of annuity payments which will be received on the basis of the annuitant's life expectancy. Where the employee has made no contributions to the plan, the full amount of each annuity payment he receives is taxable.[3]

A special provision is made in the case of benefits received from a plan to which both employer and employee have contributed where the amount of the annuity to be received in the first 3 years equals or exceeds the employee's contribution. In such cases, the employee excludes from his income the full amount of each annuity payment received until he has recovered an amount equal to his total contribution; amounts received thereafter are taxable in full.[4]

Lump-sum distribution by a qualified plan made when an employee leaves the firm in a single taxable year of the employee or his bene-

[1] Sec. 401.
[2] Sec. 402.
[3] Sec. 72.
[4] Sec. 72.

ficiary are taxed to the employee as long-term capital gains. If the distribution includes securities of the employer corporation, the tax on appreciation in value of such securities is deferred until the securities are sold.[5]

The tax treatment of the employee under nonqualified plans depends on whether his rights to benefit are nonforfeitable or contingent upon his meeting certain conditions. Where the rights are nonforfeitable, employers' contributions must be included in the employee's taxable income. Such contributions, which are currently taxable to the employee, constitute his consideration in the application of the life-expectancy annuity rule to distributed benefits. If the employee has no vested rights in the benefits of the plan, the employer's contributions on his behalf are not included in his taxable income currently. The full amount of the benefits are taxable to him, however, when received.[6]

(c) *The employer.*—The tax treatment of an employer's contributions to a retirement plan depends in the first instance on whether such plans qualify under the provisions of section 401 and, secondly, on the nature of the plan.

The employer may deduct contributions actually paid into a nonqualified plan only if the employee's rights therein are not forfeitable. If the employee, on the other hand, has no vested rights to the benefits of a funded plan, the employer may not deduct his contributions, either in the year when paid into the plan or in any subsequent year.[7]

If the retirement plan qualifies under section 401, the extent of the employer's deduction for contributions to the plan depends on whether it is a pension, profit-sharing, or stock-bonus plan.

Deductions for contributions to qualified plans, whether trusteed or not, may not exceed 5 percent of covered payrolls, except where a larger amount is necessary to provide the unfunded cost of past and current service credits, distributed as a level amount or as a level percentage of compensation for the future service of each employee. As an alternative, the employer may deduct the normal cost of the plan for the current year (on the assumption that it had been in effect since the beginning of covered service of each employee), plus 10 percent of total past and supplementary service costs as of the date they are included in the plan.[8]

Employer's contributions to qualified profit-sharing and stock-bonus plans are deductible up to 15 percent of the compensation of covered employees.[9]

Where qualified pension, profit-sharing, and/or stock-bonus plans have been established in combination, the employer's deductible contributions are limited to 25 percent of the compensation of covered employees.[10]

[5] Sec. 402.

[6] Sec. 402.

[7] If the plan is not funded, the employer may deduct payments made to the employee or his beneficiary but only in the year in which such distributions are made.

[8] Amounts contributed in excess of the deductible portion under these limitations may be deducted in succeeding taxable years to the extent of the difference between the amount contributed and the amount deductible under the limitations in each succeeding year.

[9] Contributions in excess of 15 percent of covered compensation may be carried over and deducted in succeeding taxable years within the preceding limitation. On the other hand, in years in which the contribution is less than 15 percent of covered compensation, a credit carryover arises which is available in succeeding years to absorb contributions exceeding the 15 percent limit.

[10] Sec. 404. Contributions in excess of this amount may be deducted in succeeding taxable years, providing the total deduction does not exceed 30 percent of the compensation of covered employees.

B. DEFERRED COMPENSATION CONTRACTS

Deferred compensation contracts differ from pension and similar retirement programs in that they do not constitute a formal plan providing retirement benefits for employees generally (or for a particular group of employees, where the nondiscrimination requirements of sec. 401 are observed) and, therefore, usually are not funded. Under such contracts, the employee agrees to forego a specified portion of current compensation which will be paid to him over a specified and limited period of time in the future, frequently at and following retirement.

The regulations provide that the employer is entitled to deduct amounts paid as compensation to employees in the year when paid, regardless of the fact that the employee is no longer active in the employer's behalf, so long as the total compensation for the years of active employment is reasonable. So far as the employer is concerned, therefore, salary payments under deferred compensation contracts may not be deducted until actually distributed to the employee, even though accruing in a year preceding distribution.

On the other hand, the taxability of the employee with respect to deferred compensation under these contracts is not clearly defined in the code or in the regulations. If the employee has a vested right in the deferred compensation at the time of the enactment of the contract, the amount of the total compensation deferred may be allocated pro rata to the years of active employment covered by the contract and included in the employee's income for those years. On the other hand, if the employee's rights to the deferred payments are forfeitable or contingent upon his meeting certain conditions designated by the employer and serving some bona fide business purpose for the employer, the deferred compensation probably will enter into taxable income in the year when actually received. The law or regulations do not clearly define the criteria for determining whether the contingencies specified in the deferred compensation contract are bona fide and conceived in the employer's interest rather than for the tax convenience of the employee, or whether they are effective constraints on the employee's rights to receive the compensation at a future date.

C. EMPLOYEE STOCK OPTIONS

An increasingly popular device for providing deferred compensation for employees is the restricted stock option. Under such plans, participating employees are granted options to acquire shares of the employer's stock at specified prices, usually slightly below the prevailing market price, so that if the price of the stock rises, the employee will find it profitable to exercise the option.

Under the present law, the income realized from such options generally is taxable to the recipient on the difference between the cost of the stock to him and the proceeds of the sale at the time he disposes of the stock. This rule applies where the employee does not dispose of the stock within 2 years from the date the option was granted or within 6 months from the date he acquired the stock by exercising the option. If the option price was less than 95 percent of the value of the stock at the time the option was granted, the difference between the selling price and the price paid for the stock under the option is divided into both ordinary income and capital gains. The excess of the value of the stock over the option price at the time the option was granted is treated as compensation, and the balance is generally treated as a long-term capital gain. If the option price at the time the option was granted was 95 percent or more of the fair market value, a sale or exchange of the stock held more than 6 months results only in a long-term capital gain or loss, and no compensation is deemed to have been paid.[11]

II. Issues and Proposals

The growth of private pensions, stock-bonus and profit-sharing plans, and other arrangements for deferring compensation of employees has significant implications for the development of the economy. Accordingly, the effect of tax provisions in encouraging or discouraging the further growth of these devices is a major issue in Federal tax policy.

A. ECONOMIC ISSUES IN DEFERRED COMPENSATION ARRANGEMENTS

1. "Institutionalizing" personal savings and investment

Basically, deferred compensation devices involve arrangements for saving a portion of currently accruing wage and salary income. In the case of deferred compensation contracts arrived at through negotiations between the employer and the individual employee, the amount of current salary so reserved presumably reflects the savings intentions of the employee. In other words, apart from tax considerations, such contracts may be assumed to result in no significant change in the total saving the employee intends to reserve out of his current income, including that provided in the deferred compensation contract. The reduction in tax liability afforded by the deferral of receipt of currently accruing salary, of course, may result in some increase in total current savings by the employee. While such additional saving may be substantial with respect to any one employee, it is unlikely that it is of major moment in the aggregate. Accordingly, the use of individual deferred compensation contracts may be expected to involve no significant alteration in the savings pattern for the entire economy.

On the other hand, significantly different results may follow in the case of group retirement plans, including a very large proportion of industrial pension, profit-sharing, and stock-bonus plans. In these plans, the specific terms of the deferred compensation arrangement do not reflect the individual saving intentions of covered employees. Moreover, since in many cases the employee has no vested rights in the retirement fund being built up by his employer's contributions, the recognition of his personal savings in such funds is likely to be remote. Accordingly, there may very well be no major change in his saving pattern out of his current disposable income (i. e., his take-home pay).[12]

The aggregate volume of employer contributions to such retirement plans, therefore, may be regarded to a large extent as net additions

[11] Sec. 421.

[12] Some, probably very slight, downward pressure on his savings ratio may follow from the somewhat greater assurance he enjoys with respect to his retirement, as a result of the general provision of a retirement plan.

to savings out of current wages and salaries. The continuing growth of these private retirement plans, accordingly, may be assumed to result in a higher savings rate than would exist in the absence of such plans. This is reflected in the following table which shows a steady rise in the ratio of private employer pension and welfare plan contributions to current wage and salary accruals.

Period	Non-Government wages and salaries	Employer contributions to private pension and welfare funds	Employer contributions as percent of wages and salaries
	Bil. dol.	*Bil. dol.*	*Percent*
1929	$45.5	$0.2	0.3
1930-34	151.9	.8	.5
1935-39	175.4	1.1	.6
1940-44	322.5	2.5	.8
1945-49	509.7	7.8	1.5
1950	124.3	2.7	2.2
1951	142.1	3.6	2.5
1952	152.2	4.0	2.6
1953	164.7	4.6	2.8
1954	162.4	5.1	3.1

Source: Department of Commerce.

It is contended, on the one hand, that this growth in compensation arrangements is a salutary influence for both economic growth and stabilization. In the first place, it adds to the supply of investable funds available for industry, facilitating the financing of industrial expansion. It is recognized that this result depends in part on the disposition of the employers' contributions by the recipient trust funds and insurance companies. A recent survey by the Securities and Exchange Commission shows that an increasing proportion of pension fund assets are in corporate securities, the most pronounced growth since 1951 occurring in corporate equities. For example, United States Government bonds fell from 31 percent of total pension fund assets in 1951 to 18 percent in 1954, while common stocks rose from 11 to 19 percent over the same period.[13]

In the second place, it is argued, personal savings through deferred compensation arrangements are likely to be quite sensitive to short-term changes in levels of economic activity and accordingly to provide a stabilizing influence. Since employer contributions to pension, profit-sharing and stock-bonus plans depend on the size of payrolls or on current profits, variations in business activity will result in corresponding fractional variations in this component of personal savings. When business activity is increasing, therefore, individual savings through retirement funds will rise, exerting a dampening influence on inflationary pressure. A downturn in business activity, by the same token, will result in a decrease in this type of saving thereby exerting a countercyclical influence. Because these savings are institutionalized, i. e., are based on formal arrangements, they can more readily be counted on to move countercyclically than direct personal savings.

On the other hand, concern is sometime expressed over the long-range influence of these formalized savings arrangements. It is

[13] SEC, Statistical Series, release No. 1335, October 12, 1955, Corporate Pension Funds, 1954. The survey did not include funds administered by insurance companies, or the pension funds of banks, insurance companies, and railroads.

pointed out that sustaining economic growth may require substantial shifts in the ratio of savings to personal income corresponding with long-term shifts in the level of investment demand. While the vigorous capital expansion program of the postwar years has been a major growth-generating force, it is quite possible that sustaining full employment and growth in a future period may require a relatively more important role for consumption. Since personal savings through employer contributions to retirement funds are not geared to investment requirements, it is claimed that there may well develop a significant imbalance between savings and investment, seriously complicating the problem of sustaining economic growth.

Moreover, it is argued that although this form of institutionalized saving might show an appropriate countercyclical sensitivity if pension arrangements were stabilized, the fact that the number of such plans is on the increase results in a strong tendency toward increasing savings, regardless of economic conditions. Thus, it is pointed out that although non-Government wages and salaries decreased by $2.3 billion in 1954 as compared with 1953, employer contributions to pension and welfare funds increased by $472 million.[14]

Apart from the effects on the volume of personal savings, the growth of retirement funds has had noticeable consequences for the form such savings have taken. Leaving out of consideration the personal savings of unincorporated businesses, the largest proportions of personal savings in recent years (1951–54) have taken the form of increases in currency holdings, demand deposits, and deposits in time and savings accounts and in savings and loan associations. In the aggregate, such savings plus increases in equity in real property have accounted for all but about one-fifth to one-sixth of total personal savings exclusive of increases in equity in unincorporated enterprises.[15]

On the other hand, the bulk of pension trust funds have been invested in corporate securities during the same period. The Securities and Exchange Commission Survey shows that a rapidly increasing proportion of corporate pension and retirement fund assets are in common stocks and corporate bonds, with virtually no net increases between 1951 and 1954 in cash and deposits and U. S. Government securities. As of 1954, corporate securities accounted for 76 percent of total assets of these trusts, corporate bonds representing 53.5 percent of the total and common stocks 18.5 percent.[16]

It is apparent from these data that continued growth in private retirement plans has important implications for the disposition of personal savings. On the one hand, the investment needs of retirement funds have been regarded by some as offering a major solution to the problem of assuring an adequate supply of external funds for corporate growth. The active participation of these retirement plan trusts in the securities market, it is said, assures corporate enterprise of a ready market for its securities, and more particularly for its equity issues. Moreover, since these trusts have a relatively steady inflow of funds, they can be counted on to be active buyers, particularly at the time of market dips. Accordingly, they are credited with exercising a stabilizing influence in the securities market. Finally, trust fund investments in corporate securities, it is claimed,

[14] U. S. Department of Commerce, Survey of Current Business, July 1955, pp. 14, 20.
[15] U. S. Department of Commerce, Survey of Current Business, July 1955, p. 12.
[16] Securities and Exchange Commission, op. cit.

give an increasingly large number of individuals a stake in corporate enterprise at considerably lower risk than would attend direct investments by individuals.

On the other hand, the increased participation of pension funds in the securities market is sometimes regarded as a mixed blessing. It is contended that because of the nature of these funds, their acquisition of securities must be limited largely to the so-called blue chips. Since such securities are those in greatest demand, substantial purchases by retirement funds, it is claimed, tend to fortify the unevenness of the market. This results in increasingly adverse conditions for direct individual investment in these prime issues, which in the case of the medium- and relatively low-income investors are the only feasible issues.

Moreover, it is contended that retirement fund participation has served to immobilize a large volume of high-grade corporate securities. In contrast with mutual investment funds, many other institutional investors, and individual investors, retirement funds are generally regarded as relatively inactive in portfolio adjustment. Accordingly, securities acquired by these funds tend to be immobilized in their holdings, thereby reducing the fluidity of investable funds in the aggregate.

The aggregate effect of retirement plan acquisitions and holdings, it is claimed, is to impose an undue upward pressure on high-grade securities relative to less seasoned issues. Such imbalance in the securities market, it is claimed, necessarily has adverse implications for the allocation of investable funds among alternative opportunities.

2. Effect on labor-force mobility

A major criticism directed against deferred compensation arrangements is that they tend to reduce the mobility of covered employees and therefore contribute to a reduction in the effectiveness with which labor services are allocated among competing employers. This result, it is claimed, holds both with respect to executive employees and to hourly workers as well. Moreover, it is thought to characterize both group retirement plans and individually negotiated deferred compensation contracts.[17]

In the case of the group plan, it is pointed out, this result follows from the fact that in most cases the covered employee has no vested rights in the retirement benefits accruing on his behalf. To receive these benefits, he must meet the plan's requirements with respect to length of service and retirement age. Resigning a job for another employment, therefore, involves forfeiting the retirement benefits previously built up on his behalf. Even if the new employment involves coverage in a retirement plan, the chances are that the new retirement benefits earned will not equal those which would have been claimed had the employee remained in the first job.

By the same token, retirement plans, it is claimed, tend to enhance the bias against employment of older workers. The nondiscrimination qualifications in the tax law generally require retirement plan coverage of workers without reference to the number of years remaining until retirement age. In the case of a new employee with relatively few years remaining before retirement, however, it may well be too costly to provide the standard retirement benefits to warrant his employment.

[17] Cf., for example, Challis A. Hall, Jr., Effects of Taxation on Executive Compensation and Retirement Plans, Riverside Press, Cambridge, Mass. (1951).

In the case of the individually negotiated deferred compensation arrangement, the terms of the arrangement are very often drawn explicitly to hold the employee to the employer. In such cases, changing jobs may well encounter one of two barriers: (1) The cost to the prospective new employer of matching the retirement benefits of the present employer may be prohibitively high, or (2) the cost to the employee in terms of current salary foregone in past years in the present job may outweigh any feasible salary and retirement income provisions that might be made by the prospective employer. This will be particularly true when one of the basic purposes of the deferred compensation contract has been avoidance of current tax liability.

Opposing considerations are offered to show benefits in labor force efficiency growing out of the use of private retirement plans. In the first place, it is pointed out that some retirement plans provide vesting of employee's rights to retirement benefits, at least after some minimum period of service. In such cases, the restriction on the employee's changing jobs are relatively slight, since such a change will not involve forfeiture of retirement benefits already built up.

Secondly, many deferred compensation arrangements, it is contended, are specifically designed to foster an interest by the employee in improving the effectiveness of the employing company's operations. This is particularly apparent in the case of profit-sharing and stock-bonus plans, stock-option arrangements, and in a number of specially contrived deferred compensation contracts. Even the pension plan for hourly workers, however, is alleged to improve employee efficiency, by relieving him to a considerable extent of anxiety over financial provisions for his retirement years and by imbuing him with a sense of loyalty to the employer company. Moreover, by making it easier financially for the employee to retire at the customarily accepted retirement age, the seniority barrier to upgrading of younger employees is mitigated. This serves as a significant incentive, both at the executive and hourly worker level. In addition, the relatively younger labor force resulting from prompt retirement is said to result in higher levels of labor productivity than would result if workers were not encouraged by retirement plans to retire at relatively early ages.

B. TAX ISSUES IN DEFERRED COMPENSATION PLANS

The present tax provisions applicable to retirement plans involve a number of general issues in tax policy as well as specific problems. The general issues concern primarily the impact of these provisions on the size of the tax base, the distribution of tax burdens, and the effectiveness of income taxation in counteracting short-term economic fluctuations.

1. *Tax burden distribution*

Employer contributions to funds to provide retirement benefits for employees, it is contended, are clearly includible in the employee's compensation for his labor services. In the absence of such employer contributions, it is maintained, employment contracts would have to provide for higher current wage and salary disbursements so that the employee might make his own provisions for his retirement. In contrast with the latter, however, that portion of the employee's compensation which the employer places directly into a retirement fund is not included in the employee's income for tax purposes on a current basis.[18] These amounts are included in the employee's income only when distributed to him as benefits.

This deferral of tax on an increasingly important component of personal savings, it is contended, has a number of important ramifications for tax burden distribution. In the first place, it involves a net loss of income-tax revenue, since in virtually all cases the employee is taxable at a higher marginal rate during his earning period than during his retirement years. Given the Government's revenue requirements, the tax law necessarily involves a shift in tax burden from the labor income of individuals covered by retirement plans financed in whole or in part by employers to other forms of income, including the labor income of noncovered employees.

Secondly, it involves a basic tax discrimination with respect to various forms of personal savings. Some opponents of the present tax provisions point out that there are no inherent features in saving through formal retirement or deferred compensation plans which warrant deferral of tax as compared with individual saving through, say, United States Government savings bonds, time deposits, or corporate securities.

Those holding these views urge that wage and salary supplements of this character should be included on a current basis in the covered employee's taxable income. Furthermore, it is argued that current taxability to the employee should be made a necessary condition for the current deductibility by the employer of any contributions he makes to provide deferred compensation benefits. These rules, it is contended, should be given the widest possible application, to include, in addition to private retirement plans, social-security contributions, individually negotiated deferred-compensation arrangements, and stock-option plans, to name only the principal deferred compensation arrangements.

In the absence of such a reversal of present law, it is argued, there will be continuing pressure for labor and management to employ more and more devices for converting wage and salary payments into tax-deferred forms, involving a continuing shift in relative tax burdens to those so situated as to be unable to take advantage of any special tax provisions. As one author put it:

> Perhaps the time will come when the individual unfortunate enough to receive all of his wages in money will have an impossible tax burden.[19]

On the other hand, it is pointed out that a major stimulus for the growth of deferred compensation arrangements has been the heavy burden of individual income taxes. Straightforward wage and salary payments in amounts equal to employer contributions to retirement plans, it is pointed out, would provide less potential savings by employees for retirements. Accordingly, to match through wage and salary disbursements the accumulation of retirement benefits now possible under the present law would necessarily involve a substantially greater level of total employee compensation than the sum of the present wage and salary disbursement plus wage and salary supplements. The revenue gain from current taxability, therefore, would be slight; indeed, net revenue losses might result.

[18] Assuming the employer's plan is a qualified plan or, if not qualified, that the employee's benefit rights are forfeitable.

[19] B. U. Ratchford Symposium on Practical Limitations of the Net Income Tax, Journal of Finance, May 1952, p. 211.

Moreover, it is pointed out that requiring current taxability to the employee of employer contributions with respect to deferred compensation would involve a drastic disruption of present arrangements. Many group plans for retirement benefits cannot afford to vest each covered employee with specific benefit rights, since the overall cost for plans with vesting may considerably exceed that of nonvested plans. Including employer contributions in the income of such employees would therefore involve a difficult task of allocation and would require the employee to pay tax on an amount which may never actually be received by him. Accordingly, current taxability to the employee would be feasible only where his rights are vested. Adoption of such a rule would result in a significant contraction of the scope of employee retirement plans.

By the same token, if deductions for contributions were denied employers except where equivalent amounts are included in the employee's currently taxable income, a substantial proportion of the total current employer deductions for contributions to retirement plans would be disallowed. In view of the present high rates of tax on corporate income, the nondeductibility of these contributions would result in wholesale abandonment of broad-coverage plans in favor of more narrow coverage under vested plans.

2. Significance for contracyclical effectiveness of income taxation

The present tax provisions governing deferred compensation arrangements are also criticized as tending to run counter to fiscal policy for economic stabilization. It is contended that any provision of the law which removes sizable amounts of income from the tax base tends to reduce the built-in flexibility of the tax system. This is particularly true where the excluded income is sensitive to changes in levels of economic activity. Such is the case, it is maintained, with respect to that portion of total employee compensation represented by employer contributions to deferred compensation funds. The growth of deferred compensation plans, under the present tax law, it is argued, results in a relative shrinkage in the tax base and therefore a reduction in the automatic adjustment potential of the revenue system.

It is contended, moreover, that apart from the growth of retirement plans, the tax consequences of deductions for employer contributions to such plans are fiscally perverse. At any given level of development of such plans, it is pointed out, employer contributions will tend to vary directly with employment and size of payrolls and with profits. Accordingly, under inflationary conditions, employer tax liabilities will not rise as rapidly as they would if retirement plans contributions were not deductible nor will decreases in tax liabilities be so great when recession conditions develop. While very much the same type of perversity is observable with respect to other corporate deductions, it is particularly pronounced in the case of deferred compensation arrangements because of the immediate relationship of employer contributions to basic income factors.

On the other hand, it is pointed out that variations in the amount of employer contributions are reflections of variation in the level of an increasingly important component of personal savings. While it may be true, therefore, that the fiscal impact of the present tax arrangements may be perverse, this is more than compensated for by the corresponding and automatic changes in the volume of savings.

3. Specific tax issues

A wide range of problems has been remarked in the present tax provisions with respect to deferred compensation plans. Of these, the current issue of most interest is that arising in connection with proposals for retirement plans for self-employed individuals and others not covered by private retirement plans.

As observed above, one of the criticisms frequently directed against the present tax provisions applicable to retirement plans is that they discriminate in favor of savings for retirement by employees covered under an employer's plan and against similar savings by noncovered individuals. Thus, it is pointed out, that a lawyer, say, employed by a corporation may enjoy a very substantial tax advantage and accordingly an equivalent advantage in providing for his retirement as compared with a self-employed lawyer earning the same income.

To eliminate this tax bias, it has been proposed that self-employed individuals and others not covered by retirement plans be permitted to set up their own retirement plans with similar tax privileges. For example, such individuals would be permitted to exclude annually from their taxable income up to, say, 10 percent of their earned income (subject to some annual and cumulative limit), if the amount were set aside for retirement in a restricted fund. Benefits from the accumulated retirement funds would be fully taxable if taken in installments and taxed as long-term capital gains if withdrawn in a lump sum. In either case, benefits could not be payable until some specified retirement age, except under extraordinary circumstances.

Some opponents of this proposal argue that while it would serve to equalize treatment between those now covered and those not covered by employer plans, it would do so by extending the deficiencies in the present law. A more desirable approach to the elimination of the present tax discrimination, it is contended, would be through basic revision of the present tax provisions. Thus, it is claimed that if employer contributions to all retirement plans, public and private, were currently taxable to the employee (and deductible by the employer only if so taxable), the current discrimination would be eliminated and the occasion for special provisions for the self-employed would disappear. Other critics maintain that adoption of the proposal would result in discrimination in favor of the self-employed, since they would obtain the tax benefits with respect to completely nonforfeitable rights, which covered employees do not generally enjoy.

In addition to this broad objection, a number of specific problems are cited as arising under the proposal. These include questions with respect to integrating the proposed plans with social-security coverage and with employer-financed plans, the appropriate limits on annual and cumulative deductions, carryovers of unused deductions or deductions in excess of annual limits, etc.

Other specific tax issues raised by the present tax provisions with respect to deferred compensation concern the appropriateness of capital gains treatment for lump-sum distributions from retirement plans, the widespread use of individually negotiated deferred compensation arrangements as tax-avoidance devices, the disparate treatment of exempt trusteed fund earnings as compared with earnings of insured plans, the extent to which employers should be permitted to adopt highly differentiated plans for different groups of employees, and the extent to which private plans should be required to parallel and be integrated with public retirement programs.

FEDERAL-STATE-LOCAL GOVERNMENT FISCAL RELATIONS [1]

I. Historical Development

The principal problem in Federal-State and local government fiscal relations today is the overlapping of the revenue systems of the three levels of government. With the major exceptions of general sales, property, and motor-vehicle license taxation, all of the broad categories of revenue devices are employed at each level of government. In fact, over 80 percent of all governmental revenue in the United States is obtained from types of taxes employed by two or more levels of government.

This overlapping of revenue systems has developed principally since the early 1930's. Prior to that time, although the basic elements of the problem were in existence, the magnitude of revenue requirements at each level of government was for the most part relatively modest compared with traditional revenue sources. From the beginning of the century until World War I, an informal, but effective, separation of revenue sources existed. State and local governments depended primarily on property taxation while the Federal Government's principal revenue sources were customs and excises, particularly on alcoholic beverages and tobacco. Under the impetus of World War I revenue needs, the individual and corporate income taxes developed as important revenue sources at the Federal level.

During the 1920's, the major development in intergovernmental fiscal relations was the introduction of a credit in the Federal estate tax for State death taxes. The credit served not only to reduce the overall burden of Federal and State death taxes but to encourage uniformity in the level of State death taxes. Such uniformity was intended to deter interstate competition for wealthy residents.

The present trend in intergovernmental fiscal relations was clearly established during the 1930's. The depression increased very significantly the demands imposed on State and local government for relief and welfare services while at the same time existing and traditional revenue sources were declining in productivity. The inadequacy of property taxes, resulting from the substantial decline in property values, and the constitutional limitations on borrowing in many jurisdictions, led State and local governments to search for additional and diversified revenue sources. The following table indicates graphically the diversification of State revenue sources during this period.

[1] Much of this discussion is based on Overlapping Taxes in the United States, prepared for the Commission on Intergovernmental Relations by the Analysis Staff, Tax Division, Treasury Department, January 1, 1954, and on Federal-State-Local Tax Coordination, Tax Advisory Staff of the Secretary, Treasury Department, March 7, 1952.

Dates of adoption of major State taxes: Frequency distribution by decades

Type of tax	Decade							
	Pre-1900	1900–09	1910–19	1920–29	1930–39	1940–49	1950	Total
Death	23	14	6	2	2			47
Gift					8	4		12
Automobile registrations		30	18					48
Gasoline			4	44				48
Corporate income			7	9	15	1		32
Individual income			7	8	16			[1] 31
General sales					23	5	4	32
Distilled spirits					28	1		29
Liquor monopoly					17			17
Cigarettes				7	19	14	1	41
Total	23	34	42	70	128	25	5	

[1] Includes New Hampshire and Tennessee taxes which apply only to interest and dividend income.

Source: Overlapping Taxes in the United States, Analysis Staff, Tax Division, Treasury Department, p. 14.

Concurrently, Federal participation in social-welfare programs was increasing, both through direct assumption of responsibility and through financial assistance to States and their subdivisions. Thus, from 1932 through the remainder of the decade, both Federal receipts and expenditures increased in relation to total Government revenue and outlays.

The outbreak of World War II arrested the growing pressures in intergovernmental finances. Rapidly rising incomes increased State and local government tax yields while expenditures by these governments were necessarily restricted to nonpostponable essentials. Federal revenue requirements increased very rapidly, resulting in a substantial expansion of excise taxes and increases in individual and corporate income-tax levies.

From the end of the war until 1950, State and local government revenues continued upward, reflecting the general expansion of the economy. Rapidly rising property values and the expansion of the property tax base were particularly significant at the local level. At the State level, many of the levies adopted during the depression years of the 1930's became increasingly important revenue sources; this was particularly true of general sales and corporate and individual income taxes.

At the same time, revenue requirements at the State and local levels have grown very rapidly. Especially pressing have been the needs for additional schools, highways, and health facilities. The rapid population increase underlying these growing needs has also required more elaborate systems of police and fire protection, sewage disposal and water supply, and in a large number of communities, urban redevelopment. Concurrently, Federal revenue requirements, particularly for defense, remain high.

At the middle of the century, the problems of intergovernmental fiscal relations appear to be increasing. State governments continue the search for new revenue sources while increasing tax rates under existing levies. Many States have given the property tax over to their subdivisions, and have granted wider latitudes in taxing powers. Local governments continue to rely primarily on property taxation, although an increasing diversification through income taxation, general sales taxes, and selective excises is apparent. Although State-local overlapping in the property tax area has been almost completely eliminated through the States surrendering this source to their subdivisions, overlapping is increasing in other areas as local governments make greater use of nonproperty taxes such as income, retail sales, motor fuel, and cigarette taxes.

II. Issues and Proposals

A. ALLOCATION OF GOVERNMENT FUNCTIONS

Underlying the overlapping of Federal, State, and local government revenue systems is the very substantial growth in government functions since the early 1900's. Apart from Federal outlays directly and indirectly related to national defense, this growth in the scope of government activities has been largely the result of the increased demand for public services accompanying industrialization and urbanization.

In the process of meeting these demands, the Federal Government has frequently taken the lead, sometimes because the State and local governments were financially incapable of doing so, sometimes because the problems giving rise to the demands have been so broad as to cross local and State jurisdictions. At the same time, shifts in responsibilities have occurred between the State and local levels, reflecting in many cases the increasing concentration of the population in urban centers. Often, the States have been required to assume functions formerly discharged by localities so that local governments could concentrate their more limited resources on the basic requirements of growing cities and towns.

Much of this shift in responsibility between levels of government has represented acceptance of practical expedients rather than deliberate and explicit determination of the proper allocation of functional responsibility and authority.

Accordingly, an issue frequently raised concerns explicit determination of the respective roles of the Federal, State, and local governments in meeting the aggregate demand for Government services.

On the one hand, there is a widespread bias in favor of confining a maximum amount of public services to States and localities. It is argued that State and local governments are better suited than the Federal Government for determining the needs of the communities within their jurisdictions. In view of the high degree of variability in these needs from one community to another, it is maintained, the uniformity of standards imposed by the Federal Government may often lead to inefficient use of the total resources committed to public service. Moreover, it is contended, the subsidy element in many Federal programs focusing on State or local, as opposed to nationwide, problems, tends to dull the sense of financial responsibility of the State or locality and makes it increasingly difficult for them to meet new service requirements.

Finally, it is argued, a wide range of civic benefits, basic to preserving and strengthening our most highly-prized political and social virtues, requires maximum responsibility at the local and State level.[2] According to this view, every effort should be made toward increasing

[2] Cf. the Commission on Intergovernmental Relations, Report to the President, June 1955, pp. 3, 34.

the scope of State and local government functions while reserving for the Federal Government only those functions which by their very nature exceed the jurisdictional authority of States and localities. Such explicit decentralization, it is argued, is basic to any broad solution to the problem of overlapping revenue systems.

A contrary view holds that the enlargement of Federal functions is a necessary concomitant of our industrially advanced economy. It is pointed out that apart from defense and defense-related functions, most of the increase in Federal expenditures reflects attempts to deal with problems emerging from our rapid industrial growth which are so broadly based as to exceed the competence of State and local governments. Many of the Federal programs developed or expanded during the 1930's are cited as efforts to deal with situations not limited by geographical or political boundary lines.

Moreover, it is argued that many of the continually emerging needs so vitally affect the national well-being as to transcend the traditional views of State and local government responsibilities. Particularly in the case of highways and similar public facilities, health, and education, it is contended, the Nation cannot afford to permit public programs to lag behind in any communities, whether because of lack of awareness of needs, indifference, or limitations on financial resources. While the local and State governments should be encouraged to act on their own initiative in such cases, Federal participation should also be enlarged in order to insure adequate programs.

According to this view, explicit decentralization of Government functions is not a prime objective. Rather it should be deferred until basic programs are well established and the willingness and capability of State and local governments to bear increased responsibility for them is clearly established. Coordination of revenue systems among the three levels of government, accordingly, should proceed without necessarily referring to the respective functional responsibilities of each.

A final argument is that a substantial shift in aggregate public services from the Federal to State and local governments would have significantly adverse consequences for economic stability. Such a move, it is pointed out, would necessarily involve a decline in the relative importance of Federal revenues and a commensurate increase in State and local taxes. The latter, however, are generally characterized as regressive or at best proportional in their incidence, while the Federal revenue system is predominately progressive. Accordingly, it is argued that the proposed decentralization would involve greater regressivity overall in the distribution of tax burdens. This, in turn, would mean that the overall fiscal system would become less responsive to changes in levels of economic activity, since it is the progressive Federal revenue system which primarily provides the automatic compensatory adjustments. Economic stabilization, therefore, would require a greater degree of discretionary action by the Federal Government.

B. TAX COORDINATION

Continuing growth in the American economy implies a continued rise in the level of public services. Regardless of the respective responsibilities of the Federal, State, and local governments in providing these services, it is generally agreed that coordination of revenue systems is required if the discharge of these responsibilities is to be effectively financed. A wide range of coordination methods has been and continues to be explored, both in theory and in practice.

1. Separation of revenue sources

A proposal frequently made to increase the fiscal capacity of State and local governments calls for the repeal of certain Federal taxes, leaving them for the exclusive use of States and their subdivisions.

This proposal is particularly appealing to those who hold that an explicit reallocation of government functions among various governmental levels is essential. Separation of revenue sources, it is argued, conforms with a well-established principle that each level of government should support its functions from its own, independent income. Sharing the revenue source with another level of government necessarily limits the extent to which either can expand its use of it and accordingly limits the extent to which either can expand its functions in response to new and growing requirements.

On the other hand, it is pointed out that in practice revenue separation would offer a far from ideal solution to the problem of expanding fiscal capacity. In the first place, there is no general agreement even among those proposing separation as to the specific taxes which should be allocated to each government level. The taxes that would appear to be best suited for some States and localities are rejected by others as inadequate or inappropriate to their particular situation. Differences with respect to basic economic resources, the general course of economic development, constitutional and traditional limitations on the use of specific levies—all contribute to widely divergent preferences in tax sources.

Moreover, it is pointed out that complete separation of revenue sources would not affect one of the basic problems in intergovernmental fiscal relations—the uneven geographical distribution of taxpaying potential. A coordinated program of reallocating government functions and tax sources would result in some States and localities having a revenue potential far in excess of their needs while others would be unable to provide even a minimum level of public services.

Finally, it is pointed out that some of the revenue sources which are frequently suggested for the exclusive use of States and localities can be economically employed by them only if also used by the Federal Government. These are the taxes which involve a relatively high ratio of administrative costs to revenue yield. Federal use of such taxes permits other governments to minimize administrative costs by relying heavily on Federal collection and enforcement for identification of the taxpayer and the tax base.

2. Tax sharing

A common proposal for intergovernmental tax coordination is that the Federal Government collect certain taxes and share a portion of the revenue with the States and their subdivisions. This suggestion recognizes the limits on State and local use of many revenue sources resulting from high administrative overhead. The taxes suggested for sharing are those the administration costs of which increase less than proportionately with revenues as the area of jurisdiction expands.

It has been suggested, for example, that the States and local governments withdraw from such taxes as the cigarette sales tax, which is now imposed by 41 States. Considerable savings in administration costs, it is claimed, could be obtained by adopting tax-sharing, with the tax collected at the Federal level. Moreover, tax sharing would eliminate the problem of tax collection where the cigarettes are shipped across State lines.[3]

This proposal raises major difficulties with respect to the distribution of tax revenues. Some method would have to be developed for assuring all of the States now levying such taxes that they would receive their proper share of aggregate collections. Because of the wide range of rates imposed by the several States, those with the higher rates would have to be willing to accept shares of the total revenue which, compared to the relative productivity of the State levies, would appear to be disproportionately low. Moreover, in those States in which localities also employ the revenue device to be "shared," the problem of revenue allocation would be further complicated.

3. Deductibility

More extensive use of deductibility is sometimes suggested as the most practical tax coordinating device. The Federal income tax allows deductions for income and excises taxes paid to other jurisdictions and most State income taxes allow deductions for the Federal income tax. In addition, deductions are allowed by both the Federal and State Governments in the case of certain excises.

Deductibility, it is argued, serves to minimize duplication of tax rates, contributes to uniformity of tax burdens among taxpayers living in different jurisdictions, and reduces intrajurisdictional competition. For example, the deductibility of State and local taxes for Federal income tax purposes reduces tax liability and diverts part of the impact of the State and local taxes to the Federal Government. Accordingly, States are able to impose or increase income taxes, say, without imposing an equivalent net burden on their taxpayers. On the other hand, it is pointed out that allowing deductions in one jurisdiction for the taxes paid to another does not completely eliminate multiple level taxation. In the case of income taxation, for example, some duplication of liability remains so long as rates are less than 100 percent.

4. Tax credits

The use of tax credits is often suggested as an alternative to tax deductibility as a practical coordinating device. Some use of credits is now made at all levels of government. For example, a limited credit for State death taxes paid is allowed against Federal estate-tax liability, and a 90 percent credit is allowed against the Federal payroll levy for contributions paid into State unemployment compensation plans. States frequently allow credits against their income taxes for income taxes paid to other States, and one State has used the tax-credit method as a State-local coordinating device in the cigarette-tax field.

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[3] Under legislation enacted in 1949 and strengthened in 1955, the Federal Government is assisting the States in the collection of these taxes. This legislation requires persons who ship cigarettes in interstate commerce to report the shipment to the tax authorities of the buyer's State. State officials report that firms previously engaged in interstate shipments to avoid State cigarette taxes have discontinued their operations.

Use of tax credits is urged as a better means of eliminating multiple taxation than can be achieved through tax deductions. On the other hand, it is pointed out that unlimited tax credits would result in the highest rate among competing jurisdictions becoming the standard rate for all. Since in the case of the most important (revenuewise) taxes, the Federal levy generally involves higher rates than those of State or local governments, complete crediting of the latter against corresponding Federal liabilities would tend to induce a rise in the State or local rates up to those in the Federal tax. The result would be a substantial curtailment or even the virtual elimination of these taxes as Federal revenue devices. Accordingly, it would not be possible to allow full credit against Federal income-tax liabilities, for example, for income taxes paid to State or local governments.

5. Uniformity of tax bases and tax supplements

These methods of coordination are receiving increasing attention. Particularly in the case of income taxation, there is a discernible trend toward the adoption by States of the same tax base and methods of computation employed in the Federal tax. In recent years, this uniformity has extended to the current payment system; as a result, the Federal Government is now withholding the income taxes of nine States from the wages and salaries of its employees in these various State jurisdictions.[4]

The tax supplement approach has been adopted in Alaska for income-tax purposes. The income tax is assessed at a given percentage of the Federal income-tax liability. New Mexico and Utah, which previously allowed their taxpayers the option of computing their tax as a percentage of the Federal tax liability, however, have discontinued this practice.

Tax supplements have also made some headway in State-local fiscal relations. In Mississippi, for example, the State has authorized cities to levy a tax equal to one-fourth of the State sales tax, and the local taxes are collected along with the State tax on a single return. California in 1955, in effect, made its municipal and county sales taxes supplements to the State tax by enacting a uniform sales tax law which authorizes enactment of 1 percent local sales taxes but requires the local governments to contract with the State tax administration for collection of the tax.

These developments have led to the suggestion that a substantial solution to the problem of overlapping taxes lies in the extensive use of tax supplements and joint administration. In the case of Federal-State tax relations, for example, it is suggested that the Federal income-tax return be elaborated to provide for supplemental State taxes, designated by the various States as given percentages of the Federal tax liability. Collection and enforcement activities would be concentrated at the Federal level and a pro rata sharing of these expenses would be reflected in the distributions to the State governments. The same approach might also be employed with respect to all other major revenue sources.

The principal advantage claimed for this approach is that it would integrate Federal-State-local revenue systems and in doing so would enhance overall progressivity. State and local tax systems, accord-

[4] Federal withholding of a 10th State's tax will begin January 1, 1956.

ingly, would contribute more extensively than at present to automatic economic stabilization.

Those objecting to this approach contend that it would eventually result in the States and their subdivisions becoming fiscal appendages of the Federal Government. It would tend to undermine the sense of immediate financial responsibility and would remove much of the impetus for developing new and diversified revenue sources best suited to meet the particular needs of the respective jurisdiction. Moreover, it is argued that as a practical matter, the use of tax supplements would be limited in numerous cases by the fact that the taxpayer's income or property situs is not confined to a single political jurisdiction. Allocation problems, accordingly, would be extremely difficult to resolve.

C. GRANTS-IN-AID

Particularly since the 1930's, grants-in-aid from the Federal Government to the States and their subdivisions have played an increasingly important role in intergovernmental fiscal relations. The Federal-aid system has grown out of a consciousness that certain functions normally viewed as primarily State or local responsibilities but having a national interest (for example, highways and assistance to the needy aged), were not being performed, or were being performed inadequately, at the State and local level. Generally to promote nationwide uniformity in minimum standards of service, Federal aid has been granted, conditioned upon matching or related State and local expenditures.

Another important factor leading to Federal aid has been a demand from lower levels for Federal assistance in programs which the States and the local units felt they should develop, but were financially unable to do.

Federal aid money is allocated according to formulas usually laid down in the controlling statutes. The formulas, which vary as between programs, are based on such measures of need as population, area, road mileage, per capita income, incidence of disease, etc. A few grants are allocated as a percentage of State expenditures within specified statutory limitations.

The Federal-aid system has raised a number of issues in intergovernmental fiscal relations. It is sometimes criticized as an unwarranted extension of Federal fiscal powers for the purpose of redistributing income and wealth along geographic lines. This result follows, it is claimed, from the fact that the cost of Federal aid is financed by taxes raised primarily in the relatively well-to-do States while the benefits, by the very nature of the functions to which Federal aid is allocated, redound primarily to the less fortunately situated States.

On the other hand, it is pointed out that whatever the focus of the immediate benefits from Federal aid, the entire Nation benefits from the provision of the services such aid finances. In a highly developed industrial economy such as ours, it is contended, there is a very high degree of economic interdependence. Accordingly, the entire Nation suffers, at least over the long run, from inadequate performance of essential public functions in any one community. Federal aid, by effecting minimum standards of performance throughout the country, mitigates the drag on the national economy from those States whose progress has been relatively slow. Moreover, it is claimed, in many cases it assists such States in moving forward in economic development, with positive benefits for the whole economy.

Federal aid is characterized sometimes as a means of transferring to the Federal level functions which are primarily State and local in nature. The aid system, it is contended, tends to sap the initiative of the beneficiary States and subdivisions and to induce a financial dependence on the Federal Government out of proportion to their fiscal capacities.

Supporters of more extensive use of Federal aid contend, however, that one of its primary virtues is to stimulate States in developing programs to meet growing public needs. The matching-funds arrangement generally employed, it is argued, provides a strong incentive for the States to explore their revenue potentials more fully and therefore represents a stimulus to, rather than a drag on, fiscal initiative. Finally, it is argued that Federal aid is directed primarily to programs in which the national interest is so large that the States and their subdivisions should not be required to bear the full fiscal burden. Highway construction is cited as an important case in point and health and education programs are coming to be increasingly regarded as involving joint Federal, State, and local responsibility, particularly under the pressure of defense needs.

D. FEDERAL-STATE TAX IMMUNITY

Historically, immunity problems have created many sore points in Federal-State fiscal relations. The difficulties stem in part from the fact that the immunities are not spelled out in the Constitution, but arise from a long line of judicial decisions beginning early [5] in the life of the Nation when Federal-State relations were far different than they are today. For 80 years the court continued to broaden the range of immunities. In more recent years, the scope of immunities has been narrowed.

The principal tax immunity problems of current interest are (1) the exemption of properties of the Federal Government and its agencies from State and local property taxes, and (2) the mutual income-tax exemption of Federal and State interest on Government obligations.

At the present time, no consistent pattern is followed in determining the revenue contribution to the States and localities with respect to Federal properties. Some small amount of Federal property is subject to taxation in the same way as private property. In other cases, payments in lieu of property taxes are made. For a third group of properties, the Federal Government shares the revenue derived therefrom. In other cases, no payments are made.

The lack of an established system in this context is frequently criticized by affected States and localities. Since providing for the general taxability of Federal properties would probably open the whole question of Federal-State tax immunities, it is sometimes proposed that a general system of in-lieu payments be established. On the other hand, it is recognized that any formal system of such payments would in effect represent Federal property taxation by the

[5] Principally *McCulloch* v. *Maryland*, 4 Wheat. 316 (1819).

States or their subdivisions. Accordingly, it is suggested that this step should be regarded as an integral part of a general revolution of intergovernmental tax status.

The Federal income-tax law specifically excludes from gross income amounts received as interest on the obligations of State and local governments.[6] Apart from the constitutional issues involved, this provision has been justified as a means of keeping State and local government interest costs at manageable levels. On the other hand, the provision is criticized as an unwarranted Federal tax subsidy of State and local government debt, the benefits of which accrue primarily to high-income taxpayers. Tax exemption is also criticized as constituting a strong inducement for diversion of investable funds away from the corporate security market.

[6] Sec. 103 (a).

FEDERAL ESTATE AND GIFT TAXATION

I. Present Law

A. Estate Tax

The Federal estate tax is an excise tax imposed on the transfer of property by a decedent. It differs, therefore, from inheritance taxes in which the tax is imposed, generally, on the privilege of an heir to receive the property.

The base of the estate tax is the gross estate transferred, adjusted for certain deductions and exemptions.[1] The amount of the estate-tax liability may also be adjusted by certain allowable credits.[2] The tax is imposed at graduated rates ranging from 3 percent on taxable estates not over $5,000 to 77 percent on taxable estates in excess of $10 million.[3]

An estate-tax return is required for the estate of every individual, the value of whose gross estate at the date of death exceeds the specific exemption allowable under the law in effect at the time of death.[4] Under current law, the specific exemption is $60,000.[5] The return is due within 15 months of the date of death, although extension of time for filing may be granted.[6]

Under the present law, the graduated estate-tax rates are applied to the taxable estate, defined as the gross estate less the specific exemption and certain deductions.[7] The gross estate is defined as including the total amount of property which the decedent transferred at his death.[8] The value of all property includible in the gross estate may be determined as of the date of death or as of the date 1 year after death, at the election of the executor.[9]

Specific rules in the law govern the extent to which certain property interests of the decedent, such as those in trusts, joint tenancies, community property, and property transferred during the decedent's lifetime, are includible in his gross estate.[10] Specific rules also apply with respect to the inclusion of insurance proceeds.[11] Under the 1954 Internal Revenue Code, such proceeds are included unless they are receivable by beneficiaries other than the executor and the decedent retained no incidents of ownership. In determining incidents of ownership, the new law provides that it is immaterial who paid the insurance premiums. Under the prior law (and under the new law in the case of decedents dying before August 17, 1954), insurance proceeds were includible in the gross estate, regardless of beneficiary, so

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1 Secs. 2001, 2051.
2 Secs. 2011–2016.
3 Sec. 2001.
4 Sec. 6018.
5 Sec. 2052.
6 Sec. 6075.
7 Secs. 2051–2056.
8 Sec. 2031.
9 Sec. 2032.
10 Secs. 2031–2044.
11 Sec. 2042.

long as any part of the premium was paid directly or indirectly by the decedent.

Apart from the $60,000 specific exemption, deductions from the gross estate are allowed for funeral expenses, administrative expenses, claims against the estate, and unpaid mortgages upon, or other debt with respect to, property included in the gross estate.[12] In addition, a deduction is allowed for charitable transfers.[13] No limitation is imposed on the amount of this deduction, except that it may not exceed the value of the contributed property which is required to be included in the gross estate.

Finally, a marital deduction is allowed for property passing to the decedent's husband or wife.[14] This deduction is limited to 50 percent of the "adjusted gross estate," defined as the gross estate minus the sum of the deductions listed above. The deduction for charitable transfers and the specific exemption, however, are not required to be taken into account in computing the adjusted gross estate.

Certain credits may be allowed against the estate-tax liability. The principal of these is the credit for State inheritance, legacy, or estate taxes.[15] The maximum credit allowable for State death taxes is expressed as a percentage of the decedent's taxable estate in excess of $40,000; the law provides a graduated rate table for the purpose of computing the credit. These percentages reflect the provision of the law prior to the 1954 Revenue Code, which limited the credit to 80 percent of the gross basic tax.[16]

Credit against the estate tax is also allowed for gift taxes paid by the decedent on transfers made by him during his lifetime but includible in his gross estate.[17] Such transfers, even though previously taxed as gifts, are included in the gross estate where it is found that they were made in contemplation of death. The amount of this credit is limited to the amount of the gift tax allocable to the property includible in the gross estate and may not exceed the amount of the estate tax allocable to such property.

In order to prevent the imposition of successive estate taxes on the same property within a brief period, a credit is allowed for all or part of the estate tax paid with respect to property transferred to the present decedent from another decedent within 10 years before the present decedent's death.[18] The credit is a "vanishing" one, since it is reduced by 20 percent for each full 2 years separating the deaths.

Finally, a credit is allowable for foreign death taxes with respect to property subject both to the United States and foreign estate taxes.[19] Only taxes attributable to property taxed in both the United States and the foreign country may be allowed as a credit, which is limited to that portion of the United States tax attributable to such property.

[12] Sec. 2053.
[13] Sec. 2055.
[14] Sec. 2056.
[15] Sec. 2011.
[16] Under the prior law, the estate tax consisted of a "basic" tax and an "additional" tax. The latter was added by the Revenue Act of 1932.
[17] Sec. 2012.
[18] Sec. 2013. This credit is allowed only with respect to estates of decedents dying on or after August 17, 1954. In the case of decedents dying before this date, the 1939 Internal Revenue Code allowed a deduction for property transferred to the present decedent by gift, bequest, or inheritance from a person dying within 5 years before the date of the present decedent's death.
[19] Sec. 2014.

B. GIFT TAX

Like the estate tax, the Federal gift tax is an excise upon transfers of property by gift. The tax is a liability of the person making the gift and is based upon the value of the transferred property.

The tax is imposed at graduated rates on "taxable gifts," defined as total gifts less allowable exclusions and deductions. Rates of tax are three-fourths of those under the estate tax and range from 2¼ percent of the first $5,000 of taxable gifts to 57¾ percent on gifts in excess of $10 million. The tax is cumulative; i. e., it applies each year, at the currently effective rates, to the difference between (1) the aggregate sum of all taxable gifts made since the enactment of the 1932 law, and (2) the amount of tax on the aggregate gifts made up to the beginning of the current taxable year. In determining (2), gift tax rates in effect in the current taxable year are used.[20]

In computing the amount of "taxable gifts," an annual exclusion of the first $3,000 of gifts per recipient is allowed.[21] Where a husband and wife agree to treat gifts by either as having been made one-half by each, each spouse may claim the $3,000 annual exclusion, resulting, therefore, in a maximum combined annual exclusion of $6,000.

In addition to the annual exclusion, there is a specific exemption of $30,000 of gifts.[22] This exemption may be claimed in full in a single year or, at the taxpayer's option, over a number of years until the full $30,000 exemption is exhausted. Where a married couple treats the gifts as made one-half by each, the effect is to increase the specific exemption to $60,000.

Certain deductions are also allowed in computing the amount of taxable gifts. Gifts made to charitable, civic, religious, public, and similar organizations may be deducted in full.[23] In addition, one-half of the value of gifts made between a husband and wife after April 2, 1948, is deductible from the net aggregate gifts subject to tax.[24] This marital deduction corresponds to that allowed for estate tax purposes.

C. LEGISLATIVE HISTORY

The Federal estate tax was first imposed in 1916 at rates ranging from 1 percent on taxable estates under $5,000 to 10 percent on the amount of a taxable estate in excess of $50 million. Rates were increased by successive legislation, reaching a top rate of 25 percent under the Revenue Act of 1917. In 1926 the top rate was reduced to 20 percent while the former $50,000 exemption was increased to $100,000.

The gift tax was first levied for the 2 years 1924 and 1925, on a noncumulative basis, at rates ranging from 1 percent on net gifts not in excess of $50,000 to 25 percent on the amount of gifts over $50 million. The annual per donee exclusion was $500 and a $50,000 specific exemption was provided.

In 1932, substantial revisions were made in the estate tax and the present gift tax was introduced. Under the 1932 act, the estate tax exemption was reduced from $100,000 to $50,000, and the maximum

[20] Sec. 2502.
[21] Sec. 2503.
[22] Sec. 2521.
[23] Sec. 2522.
[24] Sec. 2523.

rate was increased from 20 percent to 45 percent. Subsequent legislation during the 1930's further reduced the exemption and increased rates. Rates were again revised in 1941, providing the schedule now in effect. In 1942, the exemption was increased to its present level of $60,000.

Rates under the gift tax of 1932 were set at 75 percent of those in the estate tax. This relationship was maintained through the subsequent estate tax rate revisions. The specific exemption under the 1932 gift tax was $50,000, reduced to $40,000 in 1935, and to the present $30,000 in 1942. The annual exclusion, originally $5,000 under the 1932 act, was reduced to $4,000 in 1938 and to $3,000 in 1942.

The 1942 legislation also made a significant change in the treatment for estate and gift tax purposes of transfers between a husband and wife. Prior to that time, only one-half of the community property so transferred was taxable in community property States under the estate tax, and gifts to third parties in these States were attributed one-half to each spouse. In non-community-property States, on the other hand, the entire amount of property was taxable to the spouse accumulating it.

In an effort to equalize treatment between residents of community- and non-community-property States, the Revenue Act of 1942 provided that transfers of community property were taxable to the transferor to the extent either that the property was economically attributable to him or that he had control over its disposition.

The Revenue Act of 1948 repealed these provisions of the 1942 legislation and provided the marital deduction for estate- and gift-tax purposes. Thus, the applicable rules in community property States reverted to the pre-1942 period, while in noncommunity property States, the taxable estate is reduced by the amount transferred to the surviving spouse, but by not more than one-half the estate. A similar deduction is allowed in case of gifts, and gifts to a third person are treated as made one-half by each spouse.

D. CHARACTERISTICS OF THE ESTATE AND GIFT TAX BASES

1. *Estate tax*

Only a relatively small proportion of the adult deaths in the United States results in Federal estate-tax liability. In 1951, for example, only 18,941 taxable estate-tax returns were filed, compared with about 1.3 million adult deaths in that year.

The total value of estates for which estate-tax returns were filed in 1951 amounted to $5.5 billion, of which $4.6 billion represent gross estates on taxable returns of persons dying after December 31, 1947. Exemptions and deductions reduced this by roughly 53 percent to taxable estates of $2.2 billion.

In the case of nontaxable estate-tax returns, $844 million of gross estates were reported. Gross estates on nontaxable returns with estates of less than $100,000 accounted for roughly 60 percent of the total; on these returns the specific $60,000 exemption offset nearly 75 percent of total gross estates and the marital deduction more than accounted for the remainder. In the case of nontaxable returns reporting gross estates over $500,000, however, deductions for charitable and similar bequests represented well over half the total estate.

Total estate-tax liability in 1951 amounted to $577 million, or about 12.5 percent of total gross estates and 26.4 percent of total net estates reported on taxable returns. Returns with gross estates of $150,000 or less were about 55 percent of all taxable returns filed; they accounted, however, for only about 5 percent of total tax liability. On the other hand, returns with gross estates in excess of $1 million, accounting for about 3 percent of all taxable returns, incurred about 48 percent of the total tax liability. Tax liability as a percent of net estate ranged from 3⅛ percent on returns with gross estates of less than $70,000 to about 51 percent on those with gross estates of $10 million or more.

2. Gift tax

The total value of gifts reported on the 39,000 gift-tax returns filed for 1950 amounted to $1.1 billion, of which $578 million were reported on 8,366 taxable returns. Net gifts on taxable returns amounted to about $388 million or about 58 percent of total gifts before exclusions. Gift-tax liability aggregated $77.6 million or 23 percent of net taxable gifts.

II. Issues and Proposals

A. ROLE OF ESTATE AND GIFT TAXATION IN THE FEDERAL REVENUE SYSTEM

In recent years, net receipts from the Federal estate and gift taxes have represented a very small percentage of total Federal revenues. Although the amount of estate and gift tax liabilities has tended to increase since the pre-World War II period, the much more marked expansion of the individual and corporation income taxes and excises has resulted in a significant reduction in the relative importance of the transfer taxes. The following table shows net receipts from estate and gift taxes as a percent of total net budget receipts since 1939.

Fiscal year	Estate and gift taxes [1]	Percent of total net budget receipts	Fiscal year	Estate and gift taxes [1]	Percent of total net budget receipts
1939	$357	7.1	1948	$890	2.2
1940	357	6.9	1949	780	2.1
1941	403	5.7	1950	698	1.9
1942	421	3.4	1951	708	1.5
1943	442	2.0	1952	818	1.3
1944	507	1.2	1953	881	1.4
1945	638	1.4	1954	934	1.5
1946	669	1.7	1955 [2]	924	1.5
1947	770	1.9	1956 [3]	964	1.5

[1] Net of refunds.
[2] Preliminary.
[3] August 1955 budget estimate.

Source: U. S. Treasury Department.

The relatively small yield of these taxes in the Federal revenue system has been remarked both by proponents of more extensive reliance on estate and gift taxes, and by those favoring their elimination, at least at the Federal level. The former criticize the present taxes as evidently inadequate to achieve the objectives for which these taxes were introduced into the Revenue Code. They contend that the legislative history of the Federal estate and gift taxes clearly establishes that these taxes were regarded, at least originally, as important revenue devices. That this purpose is not being served by the present taxes, they maintain, is evidenced by the fact that even with the substantial increase in property values in recent years, combined estate and gift tax liabilities remain less than $1 billion and a very small fraction of total Federal taxes. The failure of these taxes to keep pace with other Federal revenue sources, it is claimed, is attributable, at least in part, to the disinclination of the Congress to correct those provisions of the present law which permit large amounts of property transferred by gift or at death to escape taxation.

In addition, proponents of this view maintain that the present estate and gift taxes largely fail to accomplish the important social objective generally ascribed to them. Estate and gift taxes, it is argued, are intended to prevent the continuing accumulation through successive generations of giant family fortunes and to promote a more even distribution of wealth. This objective is characterized as being of basic importance in a democratic society. A constantly increasing concentration of wealth is regarded as a serious threat to the basic tenets of such a society which seeks to offer equality of economic opportunity. While some proponents of this view favor use of these taxes to confiscate wealth transfers in excess of some stipulated amount, most would be content with an estate and gift tax system which more effectively than at present served to damp down wealth accumulations. In either case, it is maintained that an estate tax which yields only $577 million on gross estates of $4.6 billion can hardly be said to be a significant deterrent to the building up and maintaining of family fortunes. Even in the case of the largest estates reported on returns filed in 1951, it is pointed out, the estate tax claimed only 31 percent of the reported total gross estates.

Moreover, it is argued that no other form of taxation has less serious effects on the economy than the estate and gift taxes. It is contended, for example, that these taxes involve little, if any, of the adverse impact on personal incentives frequently attributed to a graduated income tax. Similarly they avoid the objections against excises with respect to their regressiveness and effects on price and competitive relationships.

Opponents of the Federal estate and gift taxes contend that their small revenue yield is a reflection of the basic deficiency of these taxes as revenue sources. It is contended that these taxes cannot be designed to be important continuing sources of revenue, since the more effectively they apply to property transfers the greater is the likelihood that future property transfers will be of continually decreasing magnitude. This is particularly true, it is claimed, under the present steeply graduated individual income-tax rates which tend to prevent heirs and donees from recouping the reduction in the estate effected by estate and gift taxation. In the same context, it is claimed that the very heavy level of income taxation since the early 1940's, coupled with the high rates of estate and gift taxation, are responsible, to a significant extent, for the failure of estate and gift taxes to retain an important revenue role.

Opponents of estate and gift taxation, in urging their elimination from the Federal revenue system, point to a number of adverse consequences of these taxes on property management and disposition. The necessity for making provision for the payment of these taxes, it is said, sets up pressure for maintaining a higher degree of liquidity in personal investment portfolios than would be dictated by nontax consideration.

This problem of providing for estate- and gift-tax payment is said to be particularly acute in the case of family businesses, in which a considerable proportion of the gross estate may constitute business property. In such cases, it is alleged, provision for tax payment may often require liquidation of business assets to the detriment of the business and prevent its continuing successful operation in the hands of the donees and heirs. The breakup of family enterprises effected by the tax, it is argued, can hardly be viewed as serving any imperative social objective. Through time, moreover, it may be expected to have adverse consequences for both income- and estate- and gift-tax revenues.

By the same token, the estate tax is said to be an important factor contributing to the absorption of relatively small business units by purchase or merger into large firms. The type of case cited in this connection is that of a relatively small company whose stock is closely held in a family so that virtually no market exists to establish the value of the holdings. Under these circumstances, uncertainty about the Internal Revenue Service's valuation of the business assets and difficulties in liquidating assets to meet the estate-tax liability, it is argued, may incline the individual to accept an offer for the purchase of his business or its merger with another company through an exchange of stock, particularly when the acquiring company's stock enjoys a good market.

On the other hand, it is contended that this effect is in fact rarely observed. In the first place, it is argued, even those estates which consist primarily of business assets are seldom so illiquid that large-scale liquidation is necessary to meet tax liability. Secondly, it is pointed out that in the infrequent cases in which liquidity is a problem, the extension of time for paying the estate tax permitted under the law very greatly reduces the likelihood that the estate will have to make forced sales of the business assets at a serious financial loss. Moreover, the individual in these circumstances can and frequently does provide for the tax-free transfer of at least a substantial part of his interests in the closely held business to members of his family during his lifetime, taking advantage of the annual exclusions and specific exemption in the gift-tax law.

B. THE MARITAL DEDUCTION

Since it was introduced into the law by the Revenue Act of 1948, the marital deduction in the estate and gift taxes has been the subject of considerable controversy. Those who favor the deduction contend that it is the only feasible way of equalizing the treatment of transfers in noncommunity property States as compared with community property jurisdictions. The method provided in the 1942 law, it is argued, was not practicable because of its requirement for determination of the spouse to which the transferred property was economically attributable.

Moreover, the marital deduction is defended in principle apart from its use as a means of equalizing treatment between community and noncommunity property States. The estate- and gift-tax law, it is argued, should recognize the common interest of a married couple in the family's fortune, and should defer the imposition of the tax until both man and wife have died and the estate is transferred to a succeeding generation.

On the other hand, it is argued that the marital deduction, whatever its merit in principle, in fact is primarily an avoidance device the value of which increases with the size of the estate. It is contended that even if the principle of deferring the tax on transfers between husband and wife until the property is transferred to their heirs is accepted, the present marital deduction goes beyond this and permits not merely deferral but in many cases a lower tax than if the property were transferred directly to the heirs. This results from the fact that the portion of the estate left to the surviving spouse and covered by the marital deduction is not taxed at the time of the first decedent's death, but is separately taxed and at a lower tax rate (because of graduation in the rate structure) when transferred to the subsequent heirs. For example, if an individual left half of a $4 million net estate to his wife and the other half to their children, the tax at his death would be $753,200 and at her death, a like amount, or a combined tax of $1,506,400. If, on the other hand, the full $4 million had been transferred by the individual directly to the children the tax would have been $1,838,200.

To avoid this reduction instead of deferral of tax, some propose that the amount previously allowed as a marital deduction be brought back into tax at the time of the surviving spouse's death. In the example given above, the taxable estate at the time of the wife's death would be regarded as $4 million, resulting in a tax of $1,838,200, against which a credit would be allowed for the $753,200 paid at the time of the husband's death.

Proponents of this method of treating transfers between spouses recognize that it would offer a strong inducement for leaving substantial amounts to the surviving spouse rather than directly to the heirs of the succeeding generation by virtue of the interest which might be accumulated on the deferred tax. They contend that this consideration is minor compared with the improvement in the use of the marital deduction as a means of confining the estate tax to a levy on transfers to the succeeding generation. Moreover, it is argued that this treatment of transfers between spouses, if applied to estates in community property jurisdictions, would provide the desired equalization.

Others urge the outright elimination of the marital deduction and the restoration of the 1942 act treatment of transfers between spouses in community-property States. They contend that the cumulative treatment of transfers between spouses, described above, would be inequitable in a substantial number of cases where the wealth of husbands and wives was separately accumulated or inherited. The estate tax, they argue, should be levied on the property which, economically speaking belonged to the decedent, without resort to the legal fictions of community property.

C. INTEGRATION OF ESTATE AND GIFT TAXES

One of the major criticisms of the present estate- and gift-tax system is that it discriminates against transfers made at death by reason of the lower gift-tax rates and the annual exclusion allowed under the gift tax in addition to the specific exemption. It is argued that the estate of an individual who found it impossible to transfer substantial amounts of property during his lifetime should not be more heavily burdened at his death than that of an individual whose property holdings offered no substantial barriers to transfers by gift.

To overcome this discrimination, the Secretary of the Treasury, in connection with the Revenue Act of 1950, proposed an integrated transfer tax.[25] The basic features of this proposal called for the cumulation of gifts during life, as under the present law, with transfers at death regarded as the final "gift" and therefore cumulated with the gifts previously made by the taxpayer. In lieu of separate exemptions for estate and gift taxes, the proposal would have provided a single $45,000 exemption, of which $15,000 would be available for transfers during life. Any unused portion of the $15,000, however, would be available at death, as well as the portion specifically reserved for final transfers.

In his testimony, the Secretary maintained that the present dual transfer tax defeats the purpose of the estate tax by permitting annual or periodic transfers by gift of relatively small amounts of property, subject therefore to lower marginal rates of tax under the gift tax, the rates under which are only three-fourths of those under the estate tax. He also pointed out that by virtue of the 1948 act provision, effective annual exclusions and specific exemptions under the gift and estate taxes were increased to $6,000, $60,000, and $120,000 respectively. The result of these revisions, he maintained, was a substantial increase in the amount of property that might be transferred tax-free.

It has also been argued that integration of the estate and gift taxes would eliminate the problem of treating gifts made in contemplation of death. Prior to the Revenue Act of 1950, the problem of determining whether a gift was made in contemplation of death as a means of avoiding the higher estate-tax rates applicable to the property if transferred at death was an exceedingly difficult one, often giving rise to litigation. Under the 1950 act, gifts made more than 3 years before death are not subject to the estate tax. While this simplifies the administration of the estate tax, it is argued that it does so at the expense of providing an attractive avoidance device.

In opposition to the proposal for an integrated transfer tax, it is contended that this proposal would defeat the major purpose of providing differentially lower rates in the gift tax, i. e., to encourage transfers of property during life in relatively small amounts and to a relatively large number of donees. By integrating the taxes, individuals would have little tax inducement to divest themselves of their estates before death. This might well result in greater accumulation than under the present circumstances.

With respect to the problem of gifts in contemplation of death, opponents of an integrated transfer tax maintain that the motives of

[25] Cf. statement of Secretary Snyder before the Committee on Ways and Means in its hearings on the Revenue Revision of 1950, 81st Cong., 2d sess., vol. 1, pp. 22–26, and accompanying exhibit 5, pp. 75–89.

the taxpayer in avoiding estate tax by transferring property during his lifetime are irrelevant. The differential between estate- and gift-tax rates, it is contended, serves to encourage such transfers, in itself a desirable objective.

D. LIFE ESTATES

Some critics of the present estate tax regard as one of its major deficiencies the failure to treat the termination of an interest in a life estate as a taxable transfer. In his 1950 proposals, the Secretary of the Treasury illustrated the use of life estates as a means of avoiding estate and gift tax for at least one generation of transferees. He pointed out that if property is left outright to a child, it may become taxable in his estate upon his death. This may be avoided under the present law by placing the property in trust for the child's life, with the body of the trust to go to, say, a grandchild upon the child's death. While the creation of the life estate is treated as a taxable transfer, the termination of the child's interest is not. Accordingly, it is contended, transfers covering at least one generation may be made free of tax. The Secretary referred to data provided by a special statistical analysis of estate-tax returns filed in 1945 to show that about 45 percent of the property transferred by individuals with net estates exceeding $500,000 had been put in such trusts.[26] To block this type of estate tax avoidance, it was proposed that the termination of life interests in estates be treated as taxable transfers.

This recommendation for treating the termination of a life interest in an estate as a taxable transfer was opposed as introducing a serious inequity. The individual enjoying such an interest, it is maintained, does not own the property to which the interest attaches. Including such property in his estate upon the termination of his interest, therefore, would involve taxing him with respect to the transfer of property over which he had no control and none of the incidents of ownership required by the general statutory provisions.

Moreover, it is contended that this treatment would, in many cases, serve to diminish the principal of the estate before it was in fact transferred. The estate therefore would be diminished not only by the tax but also by the interest on its advance collection.

E. LIFE INSURANCE

Criticism has been directed against the provision of the 1954 Revenue Code which eliminates the premium-payment test for determining whether life insurance proceeds are to be included in the decedent's gross estate. Those opposed to this provision point out that the 1942 Revenue Act had specifically provided for the inclusion of life insurance proceeds when it was discovered that wealthy individuals were increasingly converting property into insurance policies which were previously omitted from the definition of a taxable estate. The 1942 act, it is contended, recognized that life insurance, by its very nature, is a testamentary disposition of the decedent's property, and therefore properly includible in his gross estate.

[26] Op. cit., p. 23.

On the other hand, the report of the Ways and Means Committee on the 1954 provision pointed out that no other property except life insurance proceeds—

is subject to estate tax where the decedent initially purchased it and then long before his death gave away all rights to the property.[27]

Accordingly, the test as to who had purchased the insurance policy is not appropriate in determining whether the decedent owned it at the time of his death.

F. DEDUCTIONS FOR CHARITABLE CONTRIBUTIONS

The objective of providing a deduction for contributions from an estate to charitable, religious, and similar organizations is generally agreed to be a worthy one. It has been suggested, however, that some limitation be imposed on the deductibility of these contributions in order to check their use as a means of avoiding estate or gift tax liability while leaving the donated property substantially under the control of members of the decedent's family. In this connection, reference is made to arrangements whereby a charitable trust is set up to which the preferred and nonvoting common stock holdings of a family business are donated as deductible charitable contributions. Small but controlling amounts of voting common stock are transferred to the surviving members of the family, enabling them to retain control of the business property through a largely or completely tax-free transfer. Moreover, that portion of the business income claimed by the trust is exempt from the income tax. It is argued that the use of charitable trusts for such purposes is not embraced by the objective of encouraging donations to tax-exempt organizations.

On the other hand, it is contended that little, if any, use has been made of charitable trusts for avoidance of estate and gift tax liability. Where these arrangements have been made, it is pointed out, trustees have generally been chosen who represent the public interest in the type of activities for which the trust was created. To limit the deductibility of charitable contributions, it is argued, would tend to impair one of the Nation's most important financial sources for the research upon which continuing technological progress depends as well as the support for a wide range of cultural and charitable activities.

[27] H. Rept. No. 1337, 83d Cong., 2d sess., p. 91.

TABLES

GENERAL

TABLE 1.—*Selected economic indicators, 1929 to 1955*

[Dollar amounts in billions]

	1929	1939	1944	1946	1947	1948	1949	1950	1951	1952	1953	1954	1955 [1] third quarter
Gross national product [2]	$104.4	$91.1	$211.4	$209.2	$232.2	$257.3	$257.3	$285.1	$328.2	$345.2	$364.5	$360.5	$391.5
Personal consumption expenditures	$79.0	$67.6	$109.8	$146.6	$165.0	$177.6	$180.6	$194.0	$208.3	$218.3	$230.6	$236.5	$256.0
Gross private domestic investment	$16.2	$9.3	$7.1	$27.1	$29.7	$41.2	$32.5	$51.2	$56.8	$49.6	$51.4	$47.2	$60.3
Net foreign investment	$0.8	$0.9	−$2.1	$4.6	$8.9	$2.0	$0.5	−$2.2	$0.2	−$0.2	−$2.0	−$0.3	−$0.5
Government purchases of goods and services	$8.5	$13.3	$96.5	$30.9	$28.6	$36.6	$43.6	$42.0	$62.8	$77.5	$84.5	$77.0	$75.8
National income	$87.8	$72.8	$182.6	$179.6	$197.2	$221.6	$216.2	$240.0	$277.0	$289.5	$303.6	$299.7	$325.7
Personal income	$85.8	$72.9	$165.7	$178.0	$190.5	$208.7	$206.8	$227.1	$255.3	$271.1	$286.2	$287.6	$306.1
Corporate profits before tax	$9.6	$6.4	$23.3	$22.6	$29.5	$32.8	$26.2	$40.0	$41.2	$35.9	$38.3	$34.0	$44.5
Corporate profits after tax	$8.3	$5.0	$10.4	$13.4	$18.2	$20.3	$15.8	$22.1	$18.7	$16.1	$17.0	$17.0	$22.2
Undistributed profits	$2.4	$1.2	$5.7	$7.7	$11.7	$13.0	$8.3	$12.9	$9.6	$7.1	$7.7	$7.0	$11.2
Liquid savings by individuals [3]	(4)	$4.2	$41.4	$13.7	$6.7	$3.0	$2.9	$1.8	$11.3	$13.0	$11.8	$11.9	(4)
Business expenditures for new plant and equipment [5]	(4)	$5.5	(4)	$14.9	$20.6	$22.1	$19.3	$20.6	$25.6	$26.5	$28.3	$26.8	[6] $30.9
New construction	$10.8	$8.2	$5.3	$12.0	$16.7	$21.7	$22.8	$28.5	$31.2	$33.0	$35.3	$37.6	[7] $41.6
Civilian employment (millions) [8]	47.6	45.8	54.0	55.3	58.0	59.4	58.7	60.0	61.0	61.3	62.2	61.2	[9] 64.8
Unemployment (millions)	1.6	9.5	.7	2.3	2.1	2.1	3.4	3.1	1.9	1.7	1.6	3.2	[9] 2.4
Industrial production index (1947–49=100)	59	58	125	90	100	104	97	112	120	124	[10] 134	[10] 125	[9, 10] 144
Consumers' price index (1947–49=100) [11]	73.3	59.4	75.2	83.4	95.5	102.8	101.8	102.8	111.0	113.5	114.4	114.8	[9] 115.0
Wholesale price index (1947–49=100) [11]	61.9	50.1	67.6	78.7	96.4	104.4	99.2	103.1	114.8	111.6	110.1	110.3	[9] 111.2

[1] Seasonally adjusted third quarter annual rates unless otherwise indicated.
[2] Components may not add to total GNP because of rounding.
[3] Securities and Exchange Commission data.
[4] Not available.
[5] Excludes agriculture. Data from Securities and Exchange Commission and Department of Commerce.
[6] Fourth quarter estimate based on anticipated capital expenditure as reported by business in late October and November 1955.
[7] November estimate by F. W. Dodge Corp.; seasonally adjusted annual rate by the National Bureau of Economic Research.
[8] Includes part-time workers and those with jobs but not at work for such reasons as vacations, illness, bad weather, temporary layoff, and industrial disputes; excludes Armed Forces.
[9] November 1955.
[10] Preliminary estimates. Index compiled by Board of Governors of Federal Reserve System.
[11] Index compiled by Department of Labor.

Source: Department of Commerce, Economic Indicators, 1955 Historical and Descriptive Supplement to Economic Indicators.

TABLE 2.—*Federal receipts, expenditures, surplus or deficit, and public debt, fiscal years 1915–56*

[Billions of dollars]

Fiscal year	Budget receipts	Budget expenditures	Budget surplus or deficit	Adjustment to cash basis [1]	Cash surplus or deficit [1]	Public debt end of year
1915	$0.7	$0.7	−$0.06			$1.2
1916	.8	.7	+.05			1.2
1917	1.1	2.0	−0.9			3.0
1918	3.6	12.7	−9.0			12.5
1919	5.1	18.4	−13.4			25.5
1920	6.6	6.4	+.3			24.3
1921	5.6	5.1	+.5			24.0
1922	4.0	3.3	+.7			23.0
1923	3.8	3.1	+.7			22.4
1924	3.9	2.9	+1.0			21.3
1925	3.6	2.9	+.7			20.5
1926	3.8	2.9	+.9			19.6
1927	4.0	2.8	+1.2			18.5
1928	3.9	2.9	+.9			17.6
1929	3.9	3.1	+.7	+$0.2	+$0.9	16.9
1930	4.1	3.3	+.7	+.2	+.9	16.2
1931	3.1	3.6	−.5	−.5	−1.0	16.8
1932	1.9	4.7	−2.7		−2.7	19.5
1933	2.0	4.6	−2.6		−2.6	22.5
1934	3.1	6.7	−3.6	+.3	−3.3	27.1
1935	3.7	6.5	−2.8	+.4	−2.4	28.7
1936	4.1	8.5	−4.4	+.9	−3.5	33.8
1937	5.0	7.8	−2.8		−2.8	36.4
1938	5.6	6.8	−1.2	+1.1	−.1	37.2
1939	5.0	8.9	−3.9	+1.0	−2.9	40.4
1940	5.1	9.1	−3.9	+1.2	−2.7	43.0
1941	7.1	13.3	−6.2	+1.4	−4.8	49.0
1942	12.6	34.0	−21.5	+2.1	−19.4	72.4
1943	22.0	79.4	−57.4	+3.6	−53.8	136.7
1944	43.6	95.1	−51.4	+5.3	−46.1	201.0
1945	44.5	98.4	−53.9	+8.9	−45.0	258.7
1946	39.8	60.4	−20.7	+2.5	−18.2	269.4
1947	39.8	39.0	+.8	+5.8	+6.6	258.3
1948	41.5	33.1	+8.4	+.4	+8.9	252.3
1949	37.7	39.5	−1.8	+2.8	+1.0	252.8
1950	36.5	39.6	−3.1	+.9	−2.2	257.4
1951	47.6	44.1	+3.5	+4.1	+7.6	255.2
1952	61.4	65.4	−4.0	+4.1	+.1	259.1
1953	64.8	74.3	−9.4	+4.1	−5.3	266.1
1954	64.7	67.8	−3.1	+2.9	−.2	271.3
1955	60.3	64.5	−4.2	+1.2	−3.0	274.4
1956 [2]	62.1	63.8	−1.7	+2.0	+.3	275.0

[1] Not available for years prior to 1929.
[2] Estimated.

Source: Treasury Department and Bureau of the Budget.

TABLE 3.—*Federal budget expenditures by major programs, fiscal years 1946–56* [1]

Fiscal year	Total budget expenditures	Major national security programs	Veterans services and interest on the debt	All other
	Amounts (billions)			
1946	$60.4	$43.5	$9.2	$7.7
1947	39.0	14.4	12.3	12.3
1948	33.1	11.7	11.8	9.6
1949	39.5	12.9	12.1	14.5
1950	39.6	13.0	12.4	14.2
1951	44.1	22.3	11.0	10.8
1952	65.4	43.8	10.7	10.9
1953	74.3	50.3	10.8	13.2
1954	67.8	46.5	10.6	10.6
1955	64.5	40.4	10.9	13.2
1956 [2]	63.8	38.8	11.6	13.4
	Percentage distribution			
1946	100.0	72.0	15.2	12.7
1947	100.0	36.9	31.5	31.5
1948	100.0	35.3	35.6	29.0
1949	100.0	32.7	30.6	36.7
1950	100.0	32.8	31.3	35.9
1951	100.0	50.6	24.9	24.5
1952	100.0	67.0	16.4	16.7
1953	100.0	67.7	14.5	17.8
1954	100.0	68.6	15.6	15.6
1955	100.0	62.6	16.9	20.5
1956 [2]	100.0	60.8	18.2	21.0

[1] Figures are adjusted to the 1955 concept.
[2] Estimated.

NOTE.—Detail may not add to totals because of rounding.

Source: Bureau of the Budget.

TABLE 4.—*Federal budget receipts by source, fiscal years 1939–1956* [1]

Fiscal year	Total budget receipts	Individual income tax	Corporation income and excess profits taxes	Excise taxes	Customs	Net employment taxes [2]	Estate and gift taxes	Miscellaneous receipts [3]
	Amounts (millions of dollars)							
1939	$4,996	$1,022	$1,138	$1,861	$302	$128	$357	$188
1940	5,144	959	1,123	1,973	331	164	357	237
1941	7,103	1,400	2,029	2,555	365	116	403	235
1942	12,556	3,205	4,727	3,393	369	155	421	286
1943	21,987	6,490	9,570	4,093	308	160	442	924
1944	43,636	19,701	14,737	4,761	417	200	507	3,313
1945	44,475	18,415	15,146	6,267	341	188	638	3,480
1946	39,772	16,157	11,833	6,999	424	214	669	3,476
1947	39,787	17,835	8,569	7,207	477	315	770	4,614
1948	41,488	19,305	9,678	7,356	403	49	890	3,807
1949	37,696	15,548	11,195	7,502	367	235	780	2,069
1950	36,495	15,745	10,448	7,549	407	226	698	1,422
1951	47,568	21,643	14,106	8,648	609	234	708	1,620
1952	61,393	27,912	21,225	8,851	533	260	818	1,794
1953	64,825	30,108	21,238	9,868	596	275	881	1,859
1954	64,655	29,542	21,101	9,954	541	283	934	2,300
1955 [4]	60,303	28,747	17,861	9,122	585	578	924	2,486
1956 [5]	62,100	29,755	18,850	9,272	620	282	964	2,357
	Percentage distribution							
1939	100.0	20.5	22.8	37.2	6.0	2.6	7.1	3.8
1940	100.0	18.7	21.8	38.4	6.4	3.2	6.9	4.6
1941	100.0	19.7	28.6	36.0	5.1	1.6	5.7	3.3
1942	100.0	25.5	37.7	27.0	2.9	1.2	3.4	2.3
1943	100.0	29.6	43.5	18.6	1.4	.7	2.0	4.2
1944	100.0	45.1	33.8	10.9	.9	.5	1.2	7.6
1945	100.0	41.4	34.1	14.1	.8	.4	1.4	7.8
1946	100.0	40.6	29.8	17.6	1.1	.5	1.7	8.7
1947	100.0	44.8	21.6	18.1	1.2	.8	1.9	11.6
1948	100.0	46.5	23.3	17.7	1.0	.1	2.2	9.2
1949	100.0	41.2	29.7	19.9	1.0	.6	2.1	5.5
1950	100.0	43.2	28.6	20.7	1.1	.6	1.9	3.9
1951	100.0	45.5	29.6	18.2	1.3	.5	1.5	3.4
1952	100.0	45.5	34.6	14.4	.9	.4	1.3	2.9
1953	100.0	46.4	32.8	15.2	.9	.4	1.4	2.9
1954	100.0	45.7	32.6	15.4	.8	.4	1.5	3.6
1955 [4]	100.0	47.7	29.6	15.1	1.0	1.0	1.5	4.1
1956 [5]	100.0	47.9	30.4	14.9	1.0	.5	1.5	3.8

[1] Net after trust-fund appropriations.
[2] Net after deducting appropriations to Federal old-age and survivors insurance trust fund and railroad retirement account.
[3] Includes such items as proceeds from sale of surplus property and from Government-owned securities, deposits resulting from renegotiation of war contracts, repayment on credit to United Kingdom, recoveries, refunds, gifts, license fees, fines, etc.
[4] Preliminary.
[5] August 1955 budget estimates.

NOTE.—Amounts shown in this table differ from receipts as presented in the budget in that trust fund appropriations and refunds of receipts have been allocated among the various sources.

Source: Treasury Department.

TABLE 5.—*Relationship of Federal, State, and local government receipts to national income, 1929–54*

[Dollar amounts in billions]

Calendar year	National income	Receipts					
		Amounts			Percent of national income		
		Total	Federal	State and local [1]	Total	Federal	State and local [1]
1929	$87.8	$11.3	$3.8	$7.5	12.9	4.3	8.5
1930	75.7	10.8	3.0	7.7	14.3	4.0	10.2
1931	59.7	9.5	2.0	7.4	15.9	3.4	12.4
1932	42.5	8.9	1.7	7.2	20.9	4.0	16.9
1933	40.2	9.3	2.7	6.7	23.1	6.7	16.7
1934	49.0	10.5	3.5	6.9	21.4	7.1	14.1
1935	57.1	11.4	4.0	7.4	20.0	7.0	13.0
1936	64.9	12.9	5.0	7.9	19.9	7.7	12.2
1937	73.6	15.4	7.0	8.3	20.9	9.5	11.3
1938	67.6	15.0	6.5	8.5	22.2	9.6	12.6
1939	72.8	15.4	6.7	8.7	21.2	9.2	12.0
1940	81.6	17.7	8.6	9.1	21.7	10.5	11.2
1941	104.7	25.0	15.4	9.6	23.9	14.7	9.2
1942	137.7	32.6	22.9	9.7	23.7	16.6	7.0
1943	170.3	49.2	39.3	9.9	28.9	23.1	5.8
1944	182.6	51.2	41.0	10.2	28.0	22.5	5.6
1945	181.2	53.2	42.5	10.7	29.4	23.5	5.9
1946	179.6	51.2	39.2	12.0	28.5	21.8	6.7
1947	197.2	57.1	43.3	13.8	29.0	22.0	7.0
1948	221.6	59.3	43.4	15.8	26.8	19.6	7.1
1949	216.2	56.5	39.1	17.4	26.1	18.1	8.0
1950	240.0	69.4	50.2	19.2	28.9	20.9	8.0
1951	277.0	85.6	64.5	21.1	30.9	23.3	7.6
1952	289.5	91.1	68.2	22.9	31.5	23.6	7.9
1953	303.6	95.9	71.3	24.6	31.6	23.5	8.1
1954	299.7	89.8	63.5	26.3	30.0	21.2	8.8
1955 [2]	320.7	97.4	69.6	27.8	30.4	21.7	8.7

[1] State and local receipts have been adjusted to exclude Federal grants-in-aid.
[2] Second quarter estimates at seasonally adjusted annual rates.

NOTE.—The Department of Commerce concept of receipts used in this table differs from both "budget" and "cash" receipts as defined in the budget message. In this table, receipts of trust funds and taxes other than corporation taxes are on a cash basis and receipts from corporation taxes are on an accrual basis. Details may not add to totals because of rounding.

Source: Department of Commerce.

TABLE 6.—*Relationship of Federal, State, and local government expenditures to national income, 1929–54*

[Dollar amounts in billions]

Calendar year	National income	Expenditures: Amounts: Total	Expenditures: Amounts: Federal	Expenditures: Amounts: State and local [1]	Percent of national income: Total	Percent of national income: Federal	Percent of national income: State and local [1]
1929	$87.8	$10.2	$2.6	$7.6	11.6	3.0	8.7
1930	75.7	11.0	2.8	8.3	14.5	3.7	11.0
1931	59.7	12.3	4.2	8.1	20.6	7.0	13.6
1932	42.5	10.6	3.2	7.4	24.9	7.5	17.4
1933	40.2	10.7	4.0	6.7	26.6	10.0	16.7
1934	49.0	12.8	6.4	6.4	26.1	13.1	13.1
1935	57.1	13.3	6.5	6.8	23.3	11.4	11.9
1936	64.9	15.9	8.5	7.4	24.5	13.1	11.4
1937	73.6	14.8	7.2	7.6	20.1	9.8	10.3
1938	67.6	16.6	8.5	8.1	24.6	12.6	12.0
1939	72.8	17.5	9.0	8.6	24.0	12.4	11.8
1940	81.6	18.5	10.1	8.4	22.7	12.4	10.3
1941	104.7	28.8	20.5	8.2	27.5	19.6	7.8
1942	137.7	64.0	56.1	7.9	46.5	40.7	5.7
1943	170.3	93.4	86.0	7.4	54.8	50.5	4.3
1944	182.6	103.1	95.6	7.5	56.5	52.4	4.1
1945	181.2	92.9	84.8	8.1	51.3	46.8	4.5
1946	179.6	47.1	37.0	10.0	26.2	20.6	5.6
1947	197.2	43.9	31.1	12.8	22.3	15.8	6.5
1948	221.6	51.4	35.5	15.9	23.2	16.0	7.2
1949	216.2	59.7	41.5	18.2	27.6	19.2	8.4
1950	240.0	61.2	40.9	20.3	25.5	17.0	8.5
1951	277.0	79.4	58.0	21.4	28.7	20.9	7.7
1952	289.5	93.9	71.4	22.9	32.4	24.4	7.9
1953	303.6	102.5	77.5	24.4	33.6	25.6	8.0
1954	299.7	97.4	69.7	27.3	32.5	23.5	8.9
1955 [2]	320.7	96.6	67.0	29.6	30.1	20.9	9.2

[1] State and local expenditures have been adjusted to exclude Federal grants-in-aid.
[2] Second quarter estimates at seasonally adjusted annual rate.

NOTE.—The Department of Commerce concept of expenditures used in this table is on a "cash" basis and therefore differs from "budget" expenditures as defined in the budget message.
Detail may not add to totals because of rounding.

Source: Department of Commerce.

TABLE 7.—*Relationship of Federal, State, and local government purchases of goods and services to gross national product, 1939–55*

[Dollar amounts in billions]

Year	Gross national product	Purchases of goods and services: Amounts: Total	Amounts: Federal	Amounts: State and local	Percent of GNP: Total	Percent of GNP: Federal	Percent of GNP: State and local
1939	$91.1	$13.3	$5.2	$8.2	14.6	5.7	9.0
1940	100.6	14.1	6.2	7.9	14.0	6.2	7.9
1941	125.8	24.8	16.9	7.8	19.7	13.4	6.2
1942	159.1	59.7	52.0	7.7	37.5	32.7	4.8
1943	192.5	88.6	81.2	7.4	46.0	42.2	3.8
1944	211.4	96.5	89.0	7.5	45.6	42.1	3.5
1945	213.6	82.9	74.8	8.1	38.8	35.0	3.8
1946	209.2	30.9	20.9	10.0	14.8	10.0	4.8
1947	232.2	28.6	15.8	12.8	12.3	6.8	5.5
1948	257.3	36.6	21.0	15.6	14.2	8.2	6.1
1949	257.3	43.6	25.4	18.2	16.9	9.9	7.1
1950	285.1	42.0	22.1	19.9	14.7	7.8	7.0
1951	328.2	62.8	41.0	21.8	19.1	12.5	6.6
1952	345.2	77.5	54.3	23.2	22.5	15.7	6.7
1953	364.5	84.5	59.5	25.0	23.3	16.5	6.9
1954	360.5	77.0	49.2	27.8	21.4	13.6	7.7
1955: 3d quarter	391.5	75.8	45.5	30.2	19.4	11.6	7.7

NOTE.—Detail may not add to totals because of rounding.

Source: Department of Commerce.

TABLE 8.—*Governmental tax collections by source, fiscal year 1954*

[Dollar amounts in millions]

Tax	All governments	Federal	State	Local	Percent: All governments	Percent: Federal	Percent: State	Percent: Local
Property	$9,967		$391	$9,577	100.0		3.9	96.1
Individual income	30,669	$29,542	1,004	122	100.0	96.3	3.3	.4
Corporation income	21,879	21,101	772	7	100.0	96.4	3.5	(1)
Tobacco products	2,044	1,580	464	(2)	100.0	77.3	22.7	(2)
Alcoholic beverages	3,179	2,716	463	(2)	100.0	85.4	14.6	(2)
Motor fuel	3,063	845	2,218	(2)	100.0	27.6	72.4	(2)
Other selective sales and gross receipts	5,868	4,684	889	296	100.0	79.8	15.1	5.0
General sales and gross receipts	2,948		2,540	408	100.0	86.2		13.8
Death and gift	1,188	934	247	7	100.0	78.6	20.8	.6
Other, including licenses and permits	3,671	[3] 1,007	2,102	562	100.0	27.4	57.3	15.3
Total tax revenue	84,476	62,409	11,089	10,978	100.0	73.9	13.1	13.0

[1] Detail not available; amount, if any, included in "other."
[2] Less than 0.05 percent.
[3] Includes custom duties amounting to $542 million.

NOTE.—Detail may not add to totals because of rounding.

Source: U. S. Bureau of the Census, Summary of Governmental Finances in 1954.

TABLE 9.—*Tax collections: State, local, and all governments in the United States, 1902 to 1954* [1]

[Dollar amounts in millions]

Year	All governments, total including Federal	Combined State and local governments				State governments				Local governments			
		Total	Percent of all governments	Percent of national income [2]	Per capita	Total	Percent of all governments	Percent of national income [2]	Per capita	Total	Percent of all governments	Percent of national income [2]	Per capita
1902	$1,386	$860	62.0	(3)	$10.86	$156	11.3	(3)	$1.97	$704	50.8	(3)	$8.89
1913	2,271	1,608	70.8	(3)	16.54	301	13.3	(3)	3.10	1,308	57.6	(3)	13.45
1929	9,976	6,436	64.5	7.37	52.85	1,951	19.6	2.23	16.02	4,485	45.0	5.13	36.83
1932	8,247	6,358	77.1	15.25	50.93	1,890	22.9	4.53	15.14	4,468	54.2	10.72	35.79
1942	20,797	8,527	41.0	6.22	63.23	3,903	18.8	2.85	28.94	4,624	22.2	3.37	34.29
1945	50,075	9,193	18.4	5.03	65.70	4,307	8.6	2.36	30.78	4,886	9.8	2.67	34.92
1946	46,131	10,094	21.9	5.60	71.39	4,937	10.7	2.74	34.92	5,157	11.2	2.86	36.47
1947	46,642	11,554	24.8	5.82	80.17	5,721	12.3	2.88	39.69	5,833	12.5	2.94	40.47
1948	51,134	13,342	26.1	5.97	90.99	6,743	13.2	3.02	45.99	6,599	12.9	2.95	45.00
1949	50,358	14,790	29.4	6.84	99.14	7,376	14.6	3.41	49.44	7,414	14.7	3.43	49.70
1950	50,967	15,914	31.2	6.61	104.92	7,930	15.6	3.30	52.28	7,984	15.7	3.32	52.75
1951	63,585	17,554	27.6	6.31	113.73	8,933	14.0	3.21	57.87	8,621	13.6	3.10	55.85
1952	79,066	19,323	24.4	6.63	123.09	9,857	12.5	3.38	62.79	9,466	12.0	3.25	60.30
1953	83,704	20,908	25.0	6.89	130.97	10,552	12.6	3.46	66.10	10,356	12.4	3.41	64.87
1954	84,476	22,067	26.1	7.36	135.87	11,089	13.1	3.52	64.97	10,978	13.0	3.46	67.59

[1] Exclusive of social insurance contributions, the District of Columbia is included in local governments.

[2] Based on Department of Commerce data for calendar years.

[3] Not available.

Source: Bureau of the Census, Summary of Governmental Finances; Treasury Department, Annual Report of the Secretary of the Treasury.

INDIVIDUAL INCOME TAXES

TABLE 10.—*Number of taxable individual returns, adjusted gross income, personal income, and the individual income-tax base, 1945–55*

[Dollar amounts in billions]

Year	Number of taxable returns	Adjusted gross income [1]	Personal income [2]	Individual income tax base [3]	
				Amount	As percent of personal income
1945	42,650,505	$117.6	$171.2	$56.7	33.1
1946	37,915,696	118.1	178.0	64.8	36.4
1947	41,578,524	135.3	190.5	75.2	39.5
1948	36,411,248	142.1	208.7	74.6	35.7
1949	35,628,295	138.6	206.8	71.6	34.6
1950	38,186,682	158.5	227.1	84.2	37.1
1951	42,648,610	185.2	255.3	99.4	38.9
1952	43,876,273	198.5	271.1	107.5	39.7
1953	(4)	(4)	286.2	[5] 117.3	41.0
1954	(4)	(4)	287.6	[5] 115.2	40.1
1955	(4)	(4)	[6] 303.0	[5] 124.0	40.1

[1] Taxable returns.
[2] Department of Commerce concept.
[3] Income subject to surtax.
[4] Not available.
[5] Estimated from incomplete data.
[6] Preliminary estimate.

Source: Internal Revenue Service. Statistics of Income, Department of Commerce.

TABLE 11.—*Per capita disposable personal income in current and constant prices, 1939 and 1946–55*

Year	Per capita disposable personal income [1]	
	Current prices	1954 prices [2]
1939	$538	$1,041
1946	1,126	1,551
1947	1,173	1,410
1948	1,279	1,429
1949	1,261	1,422
1950	1,359	1,518
1951	1,465	1,515
1952	1,508	1,525
1953	1,568	1,573
1954	1,569	1,569
Seasonally adjusted annual rates:		
1954:		
I	1,568	1,565
II	1,567	1,565
III	1,563	1,561
IV	1,576	1,581
1955:		
I	1,589	1,595
II	1,620	1,627
III [3]	1,642	1,647

[1] Income less taxes. Population includes Armed Forces overseas.
[2] Dollar estimates in current prices divided by consumer price index on base 1954=100.
[3] Preliminary estimates by Council of Economic Advisers.

Source: Economic Indicators.

TABLE 12.—*Federal individual income-tax exemptions and first and top bracket rates, 1913–54*

Income year	Personal exemptions					Tax rates			
	Single	Married				First bracket		Top bracket	
		Dependents							
		No	1	2	3	Rate	Amount of income	Rate	Income over
						Percent		*Percent*	
1913–15	$3,000	$4,000	$4,000	$4,000	$4,000	1	$20,000	7	$500,000
1916	3,000	4,000	4,000	4,000	4,000	2	20,000	15	2,000,000
1917	1,000	2,000	2,200	2,400	2,600	2	2,000	67	2,000,000
1918	1,000	2,000	2,200	2,400	2,600	6	4,000	77	1,000,000
1919–20	1,000	2,000	2,200	2,400	2,600	4	4,000	73	1,000,000
1921	1,000	[1] 2,500	2,900	3,300	3,700	4	4,000	73	1,000,000
1922	1,000	[1] 2,500	2,900	3,300	3,700	4	4,000	56	200,000
1923	1,000	[1] 2,500	2,900	3,300	3,700	3	4,000	56	200,000
1924	1,000	2,500	2,900	3,300	3,700	[2] 1½	4,000	46	500,000
1925–28	1,500	3,500	3,900	4,300	4,700	[2] 1⅛	4,000	25	100,000
1929	1,500	3,500	3,900	4,300	4,700	[2] ⅜	4,000	24	100,000
1930–31	1,500	3,500	3,900	4,300	4,700	[2] 1⅛	4,000	25	100,000
1932–33	1,000	2,500	2,900	3,300	3,700	4	4,000	63	1,000,000
1934–35	1,000	2,500	2,900	3,300	3,700	[3] 4	4,000	63	1,000,000
1936–39	1,000	2,500	2,900	3,300	3,700	[3] 4	4,000	79	5,000,000
1940	800	2,000	2,400	2,800	3,200	[3] 4.4	4,000	81.1	5,000,000
1941	750	1,500	1,900	2,300	2,700	[3] 10	2,000	81	5,000,000
1942–43 [4]	500	1,200	1,550	1,900	2,250	[3] 19	2,000	88	200,000
1944–45	500	1,000	1,500	2,000	2,500	23	2,000	[5] 94	200,000
1946–47	500	1,000	1,500	2,000	2,500	19	2,000	[5] 86.45	200,000
1948–49 [6]	600	1,200	1,800	2,400	3,000	16.6	2,000	[5] 82.13	200,000
1950 [6]	600	1,200	1,800	2,400	3,000	17.4	2,000	[5] 91	200,000
1951 [6]	600	1,200	1,800	2,400	3,000	20.4	2,000	[5] 91	200,000
1952–53 [6]	600	1,200	1,800	2,400	3,000	22.2	2,000	[5] 92	200,000
1954 [6]	600	1,200	1,800	2,400	3,000	20	2,000	[5] 91	200,000

[1] If net income exceeds $5,000, married person's exemption is $2,000.
[2] After earned income credit equal to 25 percent of tax on earned income.
[3] Before earned income credit allowed as a deduction equal to 10 percent of earned net income.
[4] Exclusive of Victory tax.
[5] Subject to maximum effective rate limitation: 90 percent for 1944–45, 85.5 percent for 1946–47, 77 percent for 1948–49, 87 percent for 1950, 87.2 percent for 1951, 88 percent for 1952–53 and 87 percent for 1954.
[6] Additional exemptions of $600 are allowed to taxpayers and their spouses on account of blindness and/or age over 65.

TABLE 13.—*Effect of increasing per capita personal exemptions by $100, $200, and $400 on income-tax liabilities, at selected income levels*

MARRIED COUPLE—3 DEPENDENTS

Income before deductions and exemptions [1]	Tax liability				Tax reduction					
	Present law	$700 exemption	$800 exemption	$1,000 exemption	$700 exemption		$800 exemption		$1,000 exemption	
					Amount	Percent	Amount	Percent	Amount	Percent
$3,000										
$3,200										
$3,400	$12				$12	100.0	$12	100.0	$12	100.0
$3,600	48				48	100.0	48	100.0	48	100.0
$3,800	84				84	100.0	84	100.0	84	100.0
$4,000	120	$20			100	83.3	120	100.0	120	100.0
$4,200	156	56			100	64.1	156	100.0	156	100.0
$4,400	192	92			100	52.1	192	100.0	192	100.0
$4,600	228	128	$28		100	43.9	200	87.7	228	100.0
$4,800	264	164	64		100	37.9	200	75.8	264	100.0
$5,000	300	200	100		100	33.3	200	66.7	300	100.0
$5,200	336	236	136		100	29.8	200	59.5	336	100.0
$5,400	372	272	172		100	26.9	200	53.8	372	100.0
$5,600	408	308	208	$8	100	24.5	200	49.0	400	98.0
$5,800	444	344	244	44	100	22.5	200	45.0	400	90.1
$6,000	480	380	280	80	100	20.8	200	41.7	400	83.3
$8,000	844	740	640	440	104	12.3	204	24.2	404	47.9
$10,000	1,240	1,130	1,020	800	110	8.9	220	17.7	440	35.5
$15,000	2,330	2,200	2,070	1,810	130	5.6	260	11.2	520	22.3
$20,000	3,620	3,470	3,320	3,020	150	4.1	300	8.3	600	16.6
$25,000	5,110	4,940	4,770	4,430	170	3.3	340	6.7	680	13.3
$50,000	15,640	15,360	15,080	14,520	280	1.8	560	3.6	1,120	7.2
$100,000	44,310	43,965	43,620	42,930	345	.8	690	1.6	1,380	3.1
$500,000	356,410	355,955	355,500	354,590	455	.1	910	.3	1,820	.5
$1,000,000	765,910	765,455	765,000	764,090	455	.06	910	.1	1,820	.2

[1] Assuming deductions equal to 10 percent of income.

TABLE 14.—*Individual income-tax rate schedules under the Revenue Acts of 1944, 1945, 1948, 1950, and 1951*

[Percent]

Surtax net income	1944 act (highest wartime rates)	1945 act [1]	1948 act [1]	1950 act [2]	1951 act		
					Calendar year 1951	Calendar years 1952–53	Calendar year 1954
0 to $2,000	23	19.00	16.60	20	20.4	22.2	20
$2,000 to $4,000	25	20.90	19.36	22	22.4	24.6	22
$4,000 to $6,000	29	24.70	22.88	26	27	29	26
$6,000 to $8,000	33	28.50	26.40	30	30	34	30
$8,000 to $10,000	37	32.30	29.92	34	35	38	34
$10,000 to $12,000	41	36.10	33.44	38	39	42	38
$12,000 to $14,000	46	40.85	37.84	43	43	48	43
$14,000 to $16,000	50	44.65	41.36	47	48	53	47
$16,000 to $18,000	53	47.50	44.00	50	51	56	50
$18,000 to $20,000	56	50.35	46.64	53	54	59	53
$20,000 to $22,000	59	53.20	49.28	56	57	62	56
$22,000 to $26,000	62	56.05	51.92	59	60	66	59
$26,000 to $32,000	65	58.90	54.56	62	63	67	62
$32,000 to $38,000	68	61.75	57.20	65	66	68	65
$38,000 to $44,000	72	65.55	60.72	69	69	72	69
$44,000 to $50,000	75	68.40	63.36	72	73	75	72
$50,000 to $60,000	78	71.25	66.00	75	75	77	75
$60,000 to $70,000	81	74.10	68.64	78	78	80	78
$70,000 to $80,000	84	76.95	71.28	81	82	83	81
$80,000 to $90,000	87	79.80	73.92	84	84	85	84
$90,000 to $100,000	90	82.65	76.56	87	87	88	87
$100,000 to $136,719.10	92	84.55	78.32	89	89	90	89
$136,719.10 to $150,000			80.3225				
$150,000 to $200,000	93	85.50	81.2250	90	90	91	90
$200,000 and over [3]	94	86.45	82.1275	91	91	92	91

[1] After reductions from tentative tax.
[2] Rates applicable to 1951.
[3] Subject to the following maximum rate limitations: Revenue Act of 1944, 90 percent; Revenue Act of 1945, 85.5 percent; Revenue Act of 1948, 77 percent; Revenue Act of 1950, 87 percent; Revenue Act of 1951, rates for 1951, 87.2 percent; rates for 1952–53, 88 percent; rates for 1954, 87 percent.

TABLE 15.—*1955 individual income-tax rates, effective rates of tax at selected net-income levels*

[Percent]

Net income (after deduction but before exemption)	Single person, no dependents	Married couple, no dependents	Married couple, 2 dependents
$800	5.0	----------	----------
$1,000	8.0	----------	----------
$1,500	12.0	4.0	----------
$2,000	14.0	8.0	----------
$3,000	16.3	12.0	4.0
$4,000	17.7	14.0	8.0
$5,000	18.9	15.2	10.4
$8,000	22.3	17.7	14.4
$10,000	24.4	18.9	15.9
$15,000	29.7	21.7	19.3
$20,000	34.7	24.4	22.3
$25,000	39.2	26.9	25.1
$50,000	52.8	39.2	37.8
$100,000	66.8	52.8	51.9
$300,000	82.4	74.2	73.8
$500,000	85.9	80.7	80.5
$1,000,000	[1] 87.0	85.9	85.7

[1] Subject to maximum effective rate limitation of 87 percent.

TABLE 16.—*Effective rates of individual income tax at selected net-income levels, 1913–54*

SINGLE PERSON—NO DEPENDENTS

[Percent]

Income year	Level of net income [1]					
	$3,000	$5,000	$10,000	$50,000	$100,000	$500,000
1913–15		0.4	0.7	1.5	2.5	5.0
1916		.8	1.4	2.7	3.9	8.6
1917	1.3	2.4	4.0	10.4	16.2	38.5
1918	4.0	4.8	9.5	22.3	35.2	64.6
1919–20	2.7	3.2	6.7	18.5	31.3	60.7
1921	2.7	3.2	6.7	18.5	31.3	60.7
1922	2.7	3.2	6.0	17.4	30.2	52.1
1923	2.0	2.4	4.5	13.1	22.7	39.1
1924	1.0	1.2	2.3	12.3	22.7	39.9
1925–27	.6	.8	1.5	9.9	16.1	23.2
1928	.6	.8	1.5	9.3	15.8	23.2
1929	.2	.3	.9	8.5	14.9	22.2
1930–31	.6	.8	1.5	9.3	15.8	23.2
1932–33	2.7	3.2	6.0	17.4	30.2	52.7
1934–35	2.3	2.8	5.6	18.7	31.4	53.0
1936–39	2.3	2.8	5.6	18.7	33.4	61.0
1940	2.8	3.4	6.9	29.4	44.3	66.2
1941	7.4	9.7	14.9	41.8	53.2	69.1
1942 [2]	15.7	18.4	23.9	51.6	64.6	82.9
1943 [2]	19.1	22.1	27.8	56.1	69.7	88.4
1944–45	19.5	22.1	27.6	55.9	69.9	88.9
1946–47	16.2	18.4	23.5	50.3	63.5	81.6
1948–49	13.6	16.2	21.2	46.4	58.8	77.0
1950	14.3	16.9	22.0	48.0	60.8	79.2
1951	16.6	19.3	24.9	53.5	67.3	86.0
1952–53	18.1	21.0	27.2	56.9	69.7	87.2
1954	16.3	18.9	24.4	52.8	66.8	85.9

MARRIED PERSON—2 DEPENDENTS

Income year	$3,000	$5,000	$10,000	$50,000	$100,000	$500,000
1913–15		0.2	0.6	1.5	2.5	5.0
1916		.4	1.2	2.6	3.9	8.6
1917	0.4	1.3	3.4	10.3	16.2	38.5
1918	1.2	3.1	7.8	22.0	35.0	64.6
1919–20	.8	2.1	5.6	18.3	31.2	60.6
1921		1.4	5.3	18.3	31.1	60.6
1922		1.4	4.6	17.2	30.1	52.1
1923		1.0	3.4	12.9	22.6	39.1
1924		.5	1.4	12.1	22.5	39.9
1925–27		.2	.8	9.7	16.0	23.1
1928		.2	.8	9.1	15.7	23.1
1929		.1	.4	8.3	14.9	22.2
1930–31		.2	.8	9.1	15.7	23.1
1932–33		1.4	4.2	17.1	30.0	52.7
1934–35		1.0	3.4	17.2	30.2	52.7
1936–39		1.0	3.4	17.2	32.0	60.7
1940		1.5	4.4	27.5	42.9	65.9
1941	1.9	5.4	11.2	39.9	52.2	68.9
1942 [2]	6.4	11.8	19.1	49.7	63.5	82.7
1943 [2]	8.9	14.6	22.1	52.8	67.8	88.0
1944–45	9.2	15.1	22.5	53.7	68.6	88.6
1946–47	6.3	11.8	18.6	48.2	62.3	81.3
1948–49	3.3	8.6	13.6	33.2	45.6	71.7
1950	3.5	9.0	14.2	34.3	47.2	73.9
1951	4.1	10.6	16.2	38.5	52.6	80.7
1952–53	4.4	11.5	17.7	42.2	56.0	82.2
1954 [1]	4.0	10.4	15.9	37.8	51.9	80.5

[1] Income after deductions but before personal exemptions.
[2] Unadjusted for transition to current taxpayment.

TABLE 17.—*Itemized deductions as percent of adjusted gross income, by adjusted gross income classes, 1952*

Adjusted gross income classes	Deductions as percent of adjusted gross income						
	Contributions	Interest	Taxes	Casualty losses	Medical expenses	Miscellaneous	Total deductions
Taxable returns:							
Under $1,000	9.1	2.2	9.0	0.3	13.5	4.0	38.1
$1,000 under $3,000	5.6	2.6	4.5	.5	6.4	2.7	22.3
$3,000 under $5,000	4.5	3.5	4.1	.5	4.1	3.1	19.8
$5,000 under $10,000	3.8	3.6	4.2	.5	2.4	3.7	18.2
$10,000 under $20,000	3.7	2.6	4.4	.3	1.7	4.0	16.7
$20,000 under $30,000	3.4	1.7	4.2	.2	.9	2.7	13.2
$30,000 under $50,000	3.3	1.4	4.1	.2	.6	2.6	12.2
$50,000 under $100,000	3.7	1.3	4.0	.2	.4	2.6	12.2
$100,000 and over	6.6	1.4	4.0	.1	.2	3.2	15.6
Total taxable returns	4.1	2.9	4.2	.4	2.6	3.3	17.6
Nontaxable returns:							
Under $1,000 [1]	7.5	5.1	12.1	2.3	24.0	6.1	57.1
$1,000 under $3,000	5.5	3.8	6.4	1.1	13.7	4.6	35.1
$3,000 and over	5.0	7.2	5.6	5.2	8.1	10.3	41.4
Total nontaxable returns	5.3	5.5	6.3	3.1	11.5	7.3	39.0
Total all returns with itemized deductions [2]	4.2	3.0	4.3	.5	2.9	3.4	18.2

[1] Excludes returns with no adjusted gross income or deficit.
[2] Excludes nontaxable returns with no adjusted gross income or deficit.

NOTE.—Detail may not add to totals because of rounding.

Source: Internal Revenue Service, Statistics of Income, pt. 1.

TABLE 18.—*Distribution of income reported on 1952 individual income-tax returns, by source of income*

Adjusted gross income classes	Percent of adjusted gross income										
	Salaries and wages	Dividends	Interest	Annuities and pensions	Net profit from— Rents and royalties	Business and profession	Partnership	Net gain from sales or exchanges of capital assets	Income from estates and trusts	Other [1]	Total
Taxable returns:											
Under $1,000 [2]	83.2	0.7	0.9	0.2	1.6	11.6	1.9	0.5	0.1	−0.7	100.0
$1,000 and under $3,000	86.2	.8	.7	.4	1.4	8.4	1.8	.5	.2	−.4	100.0
$3,000 and under $5,000	91.0	.6	.4	.1	.9	5.1	1.5	.4	.1	−.1	100.0
$5,000 and under $10,000	87.7	1.2	.6	.1	1.0	5.9	2.8	.6	.3	−.2	100.0
$10,000 and under $20,000	56.6	5.9	1.7	.2	2.8	18.3	11.1	2.4	1.5	−.5	100.0
$20,000 and under $30,000	40.0	9.7	2.4	.2	3.6	22.0	16.4	3.4	3.3	−1.0	100.0
$30,000 and under $50,000	36.5	12.7	2.4	.2	3.6	19.2	18.7	4.2	3.8	−1.3	100.0
$50,000 and under $100,000	32.6	18.5	2.4	.2	3.8	13.0	19.0	6.7	5.7	−1.9	100.0
$100,000 and over	18.8	31.5	2.3	.2	3.6	5.7	13.2	16.5	11.7	−3.5	100.0
Total taxable returns	80.5	2.8	.8	.2	1.4	8.2	4.4	1.3	.8	−.4	100.0
Nontaxable returns:											
Under $1,000 [2]	80.5	2.0	2.2	1.1	6.1	9.9	.9	1.8	.4	−4.9	100.0
$1,000, under $3,000	77.8	1.2	1.3	1.7	3.6	13.2	.9	1.4	.3	−1.4	100.0
$3,000 and over	89.9	.6	.5	.1	1.2	7.3	.8	.5	.1	−1.0	100.0
Total nontaxable returns	82.5	1.3	1.3	1.2	3.6	11.0	1.0	1.6	.3	−3.8	100.0
Total all returns	80.7	2.7	.9	.3	1.6	8.4	4.1	1.3	.8	−.8	100.0

[1] Includes: Net loss from rents and royalties, business or profession and partnerships, and from sales or exchanges of capital assets; net gain and loss from sales or exchanges of property other than capital assets; and miscellaneous income.

[2] Excludes returns with no adjusted gross income or deficit.

Source: Internal Revenue Service; Statistics of Income, pt. 1.

TABLE 19.—*Income from selected sources reported on 1952 individual income tax returns, percentage distribution among adjusted gross income classes*

Adjusted gross income class	Percentage distribution									
	Salaries and wages	Dividends	Interest	Annuities and pensions	Net profit from—			Net gain from sales or exchange of capital assets	Income from estates and trusts	Adjusted gross income [1]
					Rents and royalties	Business and profession	Partnership			
Taxable returns:										
Under $1,000 [2]	0.6	0.2	0.7	0.3	0.7	0.9	0.5	0.3	0.1	[3] 0.6
$1,000, under $3,000	14.2	3.9	10.6	20.9	11.2	13.3	5.7	4.8	3.8	13.3
$3,000, under $5,000	32.9	6.2	13.1	14.3	15.6	17.7	10.9	9.1	4.7	29.2
$5,000, under $10,000	34.6	14.4	21.5	16.0	20.2	22.5	21.5	15.7	10.9	32.0
$10,000, under $20,000	5.6	17.2	16.3	6.2	14.0	17.4	21.7	14.6	15.6	8.0
$20,000, under $30,000	1.4	10.1	8.0	1.9	6.3	7.3	11.3	7.4	11.6	2.8
$30,000, under $50,000	1.2	12.4	7.4	2.1	5.9	6.1	12.2	8.6	12.7	2.7
$50,000, under $100,000	.8	13.7	5.7	1.7	4.8	3.1	9.3	10.3	14.4	2.0
$100,000 and over	.4	17.9	4.1	1.3	3.4	1.0	5.0	19.4	22.7	1.5
Total taxable returns	91.7	96.0	87.4	64.7	82.1	89.3	98.1	90.2	96.5	[3] 92.2
Nontaxable returns:										
Under $1,000 [2]	1.3	1.3	4.3	5.3	6.0	1.4	.5	4.1	1.3	[3] .8
$1,000, under $3,000	4.4	2.1	6.9	29.1	10.1	7.2	1.0	4.8	1.7	4.6
$3,000 and over	2.6	.6	1.4	.9	1.8	2.1	.4	.9	.5	2.4
Total, nontaxable returns	8.3	4.0	12.6	35.3	17.9	10.7	1.9	9.8	3.5	[3] 7.8
Total, all returns	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	[3] 100.0

[1] Includes, in addition to items listed: Net loss from rents and royalties, business and profession, partnerships, and from sales or exchange of capital assets; and miscellaneous income.

[2] Includes returns with no adjusted gross income.

[3] Adjusted gross income less adjusted gross deficit.

NOTE.—Detail may not add to totals because of rounding.

Source: Internal Revenue Service, Statistics of Income, pt. 1.

TABLE 20.—*Distribution of taxable individual income tax returns with itemized deductions by adjusted gross income classes and by surtax net income brackets, 1951*

PART I—SINGLE PERSON AND MARRIED PERSONS FILING SEPARATE RETURNS

Adjusted gross income classes	Number of returns	Size of surtax net income										
		Not over $2,000	$2,000–$4,000	$4,000–$6,000	$6,000–$8,000	$8,000–$10,000	$10,000–$20,000	$20,000–$50,000	$50,000–$100,000	$100,000–$150,000	$150,000–$200,000	Over $200,000
$600 under $2,000	659,842	659,842	---	---	---	---	---	---	---	---	---	---
$2,000, under $4,000	1,255,146	1,020,287	234,859	---	---	---	---	---	---	---	---	---
$4,000, under $6,000	371,387	71,121	281,013	19,253	---	---	---	---	---	---	---	---
$6,000, under $8,000	80,652	[1] 3,083	19,468	56,571	(1)	---	---	---	---	---	---	---
$8,000, under $10,000	30,925	384	1,965	11,304	16,716	556	---	---	---	---	---	---
$10,000, under $12,000	17,858	91	283	1,324	7,749	8,127	284	---	---	---	---	---
$12,000,under $14,000	13,392	(1)	[1] 95	388	1,287	5,687	5,885	---	---	---	---	---
$14,000, under $20,000	24,982	(1)	[1] 93	151	460	1,675	22,589	---	---	---	---	---
$20,000, under $50,000	35,135	(1)	(1)	(1)	[1] 91	[1] 99	[1] 11,096	[1] 23,709	---	---	---	---
$50,000, under $100,000	7,939	---	---	1	1	3	16	2,699	5,219	---	---	---
$100,000, under $150,000	1,697	1	---	---	---	---	1	10	831	854	---	---
$150,000, under $200,000	610	---	---	1	---	---	---	2	18	331	258	---
$200,000, or more	954	---	---	---	---	---	---	2	3	24	217	708
Total returns with surtax net income	2,500,519	1,755,196	537,818	89,035	27,503	16,163	39,911	26,430	6,071	1,209	475	708

[1] Returns subject to sampling variation of more than 100 percent.

TABLE 20.—*Distribution of taxable individual income tax returns with itemized deductions by adjusted gross income classes and by surtax net income brackets, 1951*—Continued

PART II—MARRIED PERSONS FILING JOINT RETURNS

Adjusted gross income classes	Number of returns	Size of surtax net income									
		Not over $4,000	$4,000–$8,000	$8,000–$12,000	$12,000–$20,000	$20,000–$40,000	$40,000–$100,000	$100,000–$200,000	$200,000–$300,000	$300,000–$400,000	$400,000 or more
$600, under $4,000	2,248,291	2,248,291									
$4,000, under $8,000	4,187,354	3,823,542	363,812								
$8,000, under $12,000	480,716	66,249	390,424	24,043							
$12,000, under $20,000	285,606	3,008	37,265	156,911	88,422						
$20,000, under $40,000	216,061	203	527	2,891	89,057	123,383					
$40,000, under $100,000	89,405	[1] 12	54	77	268	27,828	61,154				
$100,000, under $200,000	13,088	3	1	2	6	46	4,215	8,815			
$200,000, under $300,000	2,123				1	4	22	955	1,141		
$300,000, under $400,000	657						1	25	356	275	
$400,000 or more	777					1	1	5	21	178	571
Total returns with surtax net income	7,524,078	6,141,320	792,083	183,924	177,754	151,262	65,393	9,800	1,518	453	571

NOTE.—Detail will not add to total because of omission of returns subject to sampling variation of more than 100 percent.

Source: Internal Revenue Service, Statistics of Income, pt. 1.

CAPITAL GAINS

TABLE 21.—*Capital gains of individuals and fiduciaries and stock prices, 1917–52*

[Dollar amounts in millions]

Year	Net capital gains or losses (at 100 percent)[1]	Composite stock price index (1935–39=100)[2]	Year	Net capital gains or losses (at 100 percent)[1]	Composite stock price index (1935–39=100)[2]
1917	$248.2	72.2	1936	$661.3	117.5
1918	−68.1	64.1	1937	75.6	117.5
1919	262.8	74.6	1938	30.8	88.2
1920	−16.5	67.8	1939	31.2	94.2
1921	−639.1	58.3	1940	−79.7	88.1
1922	231.8	71.5	1941	−482.0	80.0
1923	191.7	72.9	1942	−301.1	69.4
1924	1,036.9	76.9	1943	1,122.6	91.9
1925	2,572.5	94.8	1944	1,656.3	99.8
1926	2,165.8	105.6	1945	4,290.2	121.5
1927	2,618.5	124.9	1946	6,665.7	139.9
1928	4,595.2	158.3	1947	4,377.8	123.0
1929	3,644.9	200.9	1948	4,348.7	124.4
1930	−120.6	158.2	1949	3,106.2	121.4
1931	−929.0	99.5	1950	6,073.3	146.4
1932	−1,651.7	51.2	1951	[3] 6,125.0	176.5
1933	−654.3	67.0	1952	n. a.	187.7
1934	−459.3	76.6	1953	n. a.	189.0
1935	37.5	82.9	1954	n. a.	226.7

[1] Long-term gains and losses before percentage reduction for returns with net income for the years up to and including 1943 and for returns with adjusted gross income beginning with the year 1944. The figures shown include gains and losses from the sale or exchange of property other than capital assets, since before 1938 such property was defined as capital assets.

[2] Standard & Poor's Corp., composite price index of 480 stocks including 420 industrials, 20 rails, and 40 utilities.

[3] Estimated.

Source: Seltzer, Lawrence H., The Nature and Tax Treatment of Capital Gains and Losses, National Bureau of Economic Research, 1951. Internal Revenue Service, Statistics of Income, pt. 1. Standard & Poor's Corp.

TABLE 22.—*Net gains from sales of capital assets by adjusted gross income classes, 1952*

[Dollar amounts in millions]

Adjusted gross income classes	Number of taxable returns with net capital gains	Net capital gains (100 percent)[1]	Percentage distribution: Number of taxable returns	Percentage distribution: Net capital gains (100 percent)
Under $1,000	17,455	$25.9	1.1	0.5
$1,000 and under $2,000	97,936	86.4	5.9	1.8
$2,000 and under $3,000	173,492	171.2	10.5	3.5
$3,000 and under $4,000	198,219	234.4	12.0	4.8
$4,000 and under $5,000	195,849	254.0	11.9	5.2
$5,000 and under $6,000	173,546	221.6	10.5	4.5
$6,000 and under $7,000	117,252	195.2	7.1	4.0
$7,000 and under $8,000	89,455	191.3	5.4	3.9
$8,000 and under $9,000	76,513	152.3	4.6	3.1
$9,000 and under $10,000	59,857	84.3	3.6	1.7
$10,000 and under $15,000	173,377	462.6	10.5	9.4
$15,000 and under $20,000	84,443	327.0	5.1	6.6
$20,000 and under $30,000	81,543	404.0	4.9	8.2
$30,000 and under $50,000	62,764	461.1	3.8	9.4
$50,000 and under $100,000	34,703	562.0	2.1	11.4
$100,000 and under $200,000	9,177	415.4	.6	8.4
$200,000 and under $500,000	2,347	348.8	.1	7.1
$500,000 and under $1,000,000	333	173.3	(2)	3.5
$1,000,000 or more	111	147.1	(2)	3.0
Total taxable returns	1,648,372	4,917.9	100.0	100.0
Total nontaxable returns	385,824	538.2		
Grand total	2,034,196	5,456.1		

[1] Net short-term capital gains plus net long-term capital gains (100 percent) minus net short-term capital loss, net long-term capital loss (100 percent), and capital loss carryover from 1947–1951.

[2] Less than 0.05 percent.

NOTE.—Detail may not add to totals because of rounding.

Source: Internal Revenue Service, Statistics of Income, pt. 1.

TABLE 23.—*Returns with net capital gains subject to alternative tax, 1942–52* [1]

[Dollar amounts in millions]

Year	Total number of returns with net capital gains	Returns with net capital gains subject to alternative tax: Number	Returns with net capital gains subject to alternative tax: Percent of total number of returns with net capital gains	Total net capital gains	Net capital gains subject to alternative tax: Amount	Net capital gains subject to alternative tax: Percent of total net capital gains
1942	277,539	12,507	4.5	$303.7	$127.6	42.0
1943	638,004	31,850	5.0	770.8	287.9	37.3
1944	983,492	51,993	5.3	1,109.3	368.4	33.2
1945	1,583,347	88,485	5.6	2,245.6	779.1	34.7
1946	1,975,105	84,021	4.3	3,157.8	922.8	29.2
1947	1,624,931	69,444	4.3	2,290.7	677.7	29.6
1948	1,364,697	30,896	2.3	2,262.9	550.2	24.3
1949	1,134,541	25,139	2.2	1,714.3	405.9	23.7
1950	1,556,019	49,316	3.2	3,000.4	949.3	31.6
1951	1,732,266	70,655	4.1	2,939.0	993.6	33.8
1952	1,648,372	80,700	4.9	2,558.9	1,696.3	66.3

[1] Taxable individual income-tax returns only.

Source: Internal Revenue Service, Statistics of Income, pt. 1.

TABLE 24.—*Estimated revenue yield from capital gains and income taxation, 1926–51*

[Dollar amounts in millions]

Year of liability	Individuals and fiduciary: Total individual income taxes [1]	Individuals and fiduciary: Estimated tax on capital gains and losses: Amount [2]	Individuals and fiduciary: Estimated tax on capital gains and losses: Percent of total tax	Corporations: Total corporation income and excess profits taxes [1]	Corporations: Estimated tax on capital gains and losses: Amount [2]	Corporations: Estimated tax on capital gains and losses: Percent of total tax	Individuals and corporations: Total income and excess profits taxes [1]	Individuals and corporations: Estimated tax on capital gains and losses: Amount [2]	Individuals and corporations: Estimated tax on capital gains and losses: Percent of total tax
1926	$732	$225	30.7	-------	-------	-------	-------	-------	-------
1927	831	297	35.7	-------	-------	-------	-------	-------	-------
1928	1,164	576	49.5	-------	-------	-------	-------	-------	-------
1929	1,002	421	42.0	-------	-------	-------	-------	-------	-------
1930	477	−15	−3.1	$712	−$5	−0.7	$1,189	−$20	−1.7
1931	246	−89	−36.2	399	−77	−19.3	645	−166	−25.7
1932	330	−80	−24.2	286	−93	−32.5	616	−173	−28.1
1933	374	16	4.3	423	−87	−20.6	797	−71	−8.9
1934	511	17	3.4	596	2	.3	1,107	19	1.7
1935	657	72	11.0	735	31	4.2	1,392	103	7.4
1936	1,214	171	14.1	1,191	67	5.6	2,405	238	9.9
1937	1,142	41	3.6	1,276	25	2.0	2,418	66	2.7
1938	766	12	1.6	860	22	2.6	1,626	35	2.2
1939	929	4	.4	1,232	25	2.0	2,161	29	1.3
1940	1,496	−7	−.5	2,549	−49	−1.9	4,045	−56	−1.4
1941	3,908	−86	−2.2	7,168	−164	−2.3	11,076	−250	−2.3
1942	8,927	68	.8	12,256	42	.3	21,183	110	.5
1943	[3] 14,590	266	1.8	15,926	69	.4	30,516	335	1.1
1944	16,347	354	2.2	14,884	100	.7	31,231	454	1.5
1945	17,226	721	4.2	10,795	214	2.0	28,021	935	3.3
1946	16,281	893	5.5	8,875	270	3.0	25,156	1,163	4.6
1947	18,249	644	3.5	10,981	210	1.9	29,230	854	2.9
1948	15,618	528	3.4	11,920	190	1.6	27,538	718	2.6
1949	14,682	475	3.2	9,817	190	1.9	24,499	665	2.7
1950	18,584	780	4.2	17,317	270	1.6	35,901	1,050	2.9
1951	24,650	890	3.6	22,082	330	1.5	46,732	1,220	2.6

[1] As reported in Statistics of Income.
[2] The estimated tax on capital gains and losses is not intended to show the difference in tax revenue resulting from taxing capital gain and losses as compared with not levying such a tax in the specified year. The estimated tax on capital gains and losses for each of the specified years is the difference between (1) the total individual and corporation income taxes reported in Statistics of Income, and (2) the total of such taxes which would have been realized if capital gains and losses had been entirely excluded from the tax computation. The estimates of capital gains tax revenue for the years prior to 1935 are not strictly comparable to those of 1935 and later years, particularly since deficit returns are not included in the earlier figures; as a result the estimates for 1926–34 are overstated in comparison with later years.
[3] Excludes additions to liability under the Current Tax Payment Act of 1943 amounting to $2,555,894,000.

Source: U. S. Treasury Department, tax advisory staff of the Secretary—Federal Income Tax Treatment of Capital Gains and Losses, Washington, 1951, table 2, p. 45.

CORPORATIONS

TABLE 25.—*Corporate profits and taxes, 1929 to 1955*

[Billions of dollars]

Year	Corporate profits before taxes	Corporate tax liability [1]	Corporate profits after taxes			Inventory valuation adjustment
			Total	Dividend payments	Undistributed profits	
1929	$9.6	$1.4	$8.3	$5.8	$2.4	$0.5
1933	.2	.5	−.4	2.1	−2.4	−2.1
1939	6.4	1.4	5.0	3.8	1.2	−.7
1940	9.3	2.8	6.5	4.0	2.4	−.2
1941	17.0	7.6	9.4	4.5	4.9	−2.5
1942	20.9	11.4	9.5	4.3	5.2	−1.2
1943	24.6	14.1	10.5	4.5	6.0	−.8
1944	23.3	12.9	10.4	4.7	5.7	−.3
1945	19.0	10.7	8.3	4.7	3.6	−.6
1946	22.6	9.1	13.4	5.8	7.7	−5.3
1947	29.5	11.3	18.2	6.5	11.7	−5.9
1948	32.8	12.5	20.3	7.2	13.0	−2.2
1949	26.2	10.4	15.8	7.5	8.3	1.9
1950	40.0	17.8	22.1	9.2	12.9	−4.9
1951	41.2	22.5	18.7	9.1	9.6	−1.3
1952	35.9	19.8	16.1	9.0	7.1	1.0
1953	38.3	21.3	17.0	9.3	7.7	−1.1
1954	34.0	17.1	17.0	10.0	7.0	−.2
1955: [2]						
First quarter	40.9	20.5	20.4	10.2	10.2	−1.3
Second quarter	43.0	21.6	21.4	10.7	10.7	−.8

[1] Includes Federal and State income and excess-profits taxes.
[2] Seasonally adjusted annual rates.

NOTE.—Detail may not add to totals because of rounding.

Source: Department of Commerce.

TABLE 26.—*Corporate profits as percent of national income, 1929–55*

Year	Percent of national income: Profits before taxes	Percent of national income: Profits after taxes	Year	Percent of national income: Profits before taxes	Percent of national income: Profits after taxes
1929	10.9	9.5	1948	14.8	9.2
1933	.5	−1.0	1949	12.1	7.3
1939	8.8	6.9	1950	16.7	9.2
1940	11.4	8.0	1951	14.9	6.8
1941	16.2	9.0	1952	12.4	5.6
1942	15.2	6.9	1953	12.6	5.6
1943	14.4	6.2	1954	11.3	5.7
1944	12.8	5.7	1955: [1]		
1945	10.5	4.6	1st quarter	13.1	6.6
1946	12.6	7.5	2d quarter	13.4	6.7
1947	15.0	9.2			

[1] Seasonally adjusted annual rates.

Source: Department of Commerce.

TABLE 27.—*Current assets and current liabilities of all corporations, 1943 and 1945–54* [1]

[Dollar amounts in billions]

	1943	1945	1946	1947	1948	1949	1950	1951	1952	1953	1954
Current assets:											
Cash	$21.6	$21.7	$22.8	$25.0	$25.3	$26.5	$28.1	$30.0	$30.8	$30.9	$31.7
United States securities	16.4	21.1	15.3	14.1	14.8	16.8	19.7	20.7	19.9	21.0	19.3
Notes and accounts receivable	26.9	25.9	30.7	38.3	42.4	43.0	56.8	61.5	67.4	67.4	68.6
Inventories	27.6	26.3	37.6	44.6	48.9	45.3	55.1	64.9	65.8	67.9	65.1
Other	1.3	2.4	1.7	1.6	1.6	1.4	1.7	2.1	2.4	2.4	2.6
Total	93.8	97.4	108.1	123.6	133.0	133.1	161.5	179.1	186.2	189.6	187.3
Current liabilities:											
Notes and accounts payable	26.3	25.7	31.6	37.6	39.3	37.5	48.3	54.9	59.3	58.5	56.4
Federal income tax liabilities	16.6	10.4	8.5	10.7	11.5	9.3	16.7	21.3	18.1	19.2	15.7
Other	8.7	9.7	11.8	13.2	13.5	14.0	14.9	16.5	18.7	19.3	19.4
Total	51.6	45.8	51.9	61.5	64.4	60.7	79.8	92.6	96.1	97.0	91.5
Net working capital	42.1	51.6	56.2	62.1	68.6	72.4	81.6	86.5	90.1	92.6	95.8
Sales	233.5	239.5	270.9	347.8	388.7	370.1	431.9	488.4	499.4	526.1	508.1
Ratio of current assets to current liabilities	1.8	2.1	2.1	2.0	2.1	2.2	2.0	1.9	1.9	2.0	2.0
Ratio of cash and United States securities to Federal income tax liabilities	2.3	4.1	4.5	3.6	3.5	4.7	2.9	2.4	2.8	2.7	3.2
Ratio of cash and United States securities to sales	.16	.18	.14	.11	.10	.12	.11	.10	.10	.10	.10

[1] Excludes banks and insurance companies. Assets and liabilities are as of Dec. 31.

NOTE.—Details may not add to totals because of rounding.

Source: Securities and Exchange Commission, Department of Commerce.

TABLE 28.—*Sources and uses of corporate funds, 1946–54* [1]

[Billions of dollars]

Source or use of funds	1946	1947	1948	1949	1950	1951	1952	1953	1954
Uses:									
Plant and equipment outlays	$12.5	$17.0	$18.8	$16.3	$16.9	$21.6	$22.4	$23.9	$22.4
Inventories (change in book value)	11.2	7.1	4.2	−3.6	9.8	9.4	.9	2.6	−2.8
Change in customer net receivables [2]	1.1	3.1	2.8	.9	5.0	2.0	3.1	.7	1.9
Cash and U. S. Government securities	−4.7	1.0	1.0	3.2	4.5	2.8	.1	1.2	−1.0
Other assets	−.6	(3)	.2	(3)	.3	.6	.8	−.1	.6
Total uses	19.5	28.2	27.0	16.8	36.5	36.4	27.3	28.3	21.1
Sources:									
Internal:									
Retained profits and depletion allowances	7.2	11.4	12.4	7.6	12.4	9.1	6.4	6.8	6.2
Depreciation and amortization allowances	4.2	5.2	6.2	7.1	7.8	9.0	10.4	11.7	13.1
Total internal sources	11.4	16.6	18.6	14.7	20.2	18.1	16.8	18.5	19.3
External:									
Change in Federal income tax liabilities	−1.6	2.1	1.0	−2.2	7.2	4.4	−2.9	1.3	−4.1
Other liabilities	2.1	1.5	.4	.5	1.0	1.9	2.4	.8	.3
Change in bank loans and mortgage loans	3.9	3.3	1.8	−2.3	2.6	5.4	3.1	.5	−.9
Net new issues:									
Stocks	1.3	1.4	1.2	1.6	1.7	2.7	3.0	2.3	2.2
Bonds	1.1	3.0	4.7	3.3	2.0	3.6	4.9	4.8	4.0
Total external sources	6.8	11.3	9.1	.9	14.5	18.0	10.5	9.7	1.5
Total sources	18.2	27.9	27.7	15.6	34.7	36.1	27.3	28.2	20.8
Discrepancy (uses less sources)	1.3	.3	−.7	1.2	1.8	.3	(3)	.1	.4

[1] Excluding banks and insurance companies.
[2] Receivables are net of payables which are not shown separately.
[3] Less than $50 million.

NOTE.—Detail may not add to totals because of rounding.

Source: Department of Commerce.

TABLE 29.—*Rates of return on net worth before and after taxes, all corporations with net income, 1936–52* [1]

[Dollar amounts in millions]

Year	Net income		Net worth	Net income as percent of net worth	
	Before tax	After tax		Before tax	After tax
1936	$9,102	$7,957	$105,553	8.6	7.5
1937	9,392	8,146	112,902	8.3	7.2
1938	6,369	5,525	99,553	6.4	5.5
1939	8,709	7,492	110,347	7.9	6.8
1940	11,068	8,543	116,231	9.5	7.4
1941	17,797	10,733	127,674	13.9	8.4
1942	23,785	11,647	131,183	18.1	8.9
1943	28,399	12,647	139,294	20.4	9.1
1944	26,880	12,111	144,950	18.5	8.4
1945	21,945	11,243	144,559	15.2	7.8
1946	26,681	17,971	148,635	18.0	12.1
1947	32,790	22,003	169,588	19.3	13.0
1948	35,791	24,020	188,524	19.0	12.7
1949	30,158	20,469	195,195	15.4	10.5
1950	43,704	26,536	215,714	20.3	12.3
1951	44,903	23,001	229,377	19.6	10.0
1952	40,358	21,356	239,969	16.8	8.9

[1] Returns with balance sheets only.

Source: Internal Revenue Service, Statistics of Income, pt. 2.

TABLE 30.—*Rates of return on net worth before and after taxes, all manufacturing corporations, 1936–55*

[Dollar amounts in millions]

Year	Net income		Net worth	Net income as percent of net worth	
	Before tax	After tax		Before tax	After tax
	Statistics of income data				
1936	$3,614	$3,027	$38,467	9.4	7.9
1937	3,669	3,028	41,239	8.9	7.3
1938	1,601	1,229	41,261	3.9	3.0
1939	3,559	2,930	42,438	8.4	6.9
1940	5,302	3,758	44,162	12.0	8.5
1941	10,300	5,419	48,398	21.3	11.2
1942	13,544	5,386	55,072	24.6	9.8
1943	16,416	5,986	60,688	27.0	9.9
1944	14,740	5,422	63,071	23.4	8.6
1945	10,173	4,109	64,150	15.9	6.4
1946	11,501	6,958	67,590	17.0	10.3
1947	16,474	10,232	76,673	21.5	13.3
1948	17,982	11,221	84,084	21.4	13.3
1949	14,154	8,708	88,885	15.9	9.8
1950	23,604	13,029	97,042	24.3	13.4
1951	24,693	10,633	104,725	23.6	10.2
1952	20,223	8,876	109,496	18.5	8.1
	FTC—SEC data				
1952	$22,913	$10,714	$105,065	21.8	10.2
1953	24,403	11,340	109,385	22.3	10.4
1954	20,934	11,232	115,125	18.2	9.8
1955:					
First quarter	[1] 25,948	[1] 13,340	116,591	22.3	11.4
Second quarter	[1] 29,736	[1] 15,512	119,109	25.0	13.0

[1] Annual rate.

Source: Internal Revenue Service, Statistics of Income, Part 2, Federal Trade Commission and Securities and Exchange Commission, Quarterly Financial Report, United States Manufacturing Corporations.

TABLE 31.—*Distribution of income and excess-profits tax liability, by net income classes, 1951 and 1952*

[Dollar amounts in millions]

Net income classes	Total tax liability, 1951	Returns with excess-profits tax, 1951				Total tax liability, 1952	Returns with excess-profits tax, 1952			
		Total tax	Income tax	Excess-profits tax			Total tax	Income tax	Excess-profits tax	
				Amount	Percent of total tax				Amount	Percent of total tax
Under $25,000	$603.1	$7.5	$6.7	$0.8	10.8	$641.5	$9.6	$8.6	$1.0	10.4
$25,000 under $50,000	442.8	203.7	174.3	29.4	14.4	411.6	163.7	140.8	23.0	14.0
$50,000 under $100,000	687.2	335.1	278.3	56.9	17.0	624.3	252.1	210.1	42.0	16.6
$100,000 under $250,000	1,269.1	675.1	564.3	110.8	16.4	1,124.4	498.0	417.4	80.7	16.2
$250,000 under $500,000	1,161.1	682.5	567.3	115.2	16.9	1,045.8	510.4	426.5	83.9	16.4
$500,000 under $1,000,000	1,307.5	796.9	661.7	135.2	17.0	1,148.6	585.6	489.9	95.7	16.3
$1,000,000 under $5,000,000	3,626.7	2,426.8	2,016.3	410.5	16.9	3,215.8	1,766.7	1,484.3	282.4	16.0
$5,000,000 under $10,000,000	1,927.3	1,334.7	1,106.7	228.0	17.1	1,584.3	820.5	690.0	130.5	15.9
Over $10,000,000	11,057.3	8,110.3	6,738.3	1,372.0	16.9	9,351.4	5,338.6	4,527.0	811.6	15.2
Total	22,082.1	14,572.6	12,113.9	2,458.7	16.9	19,147.7	9,945.3	8,394.6	1,550.7	15.6

NOTE.—Detail may not add to totals because of rounding.

Source: Internal Revenue Service, Statistics of Income, Pt 2.

TABLE 32.—*Section 102 deficiency assessments, fiscal years, 1940–50*

[Dollar amounts in thousands]

Fiscal year of assessment	Number	Amount	Fiscal year of assessment	Number	Amount
1940	30	$130	1947	81	$800
1941	106	832	1948	66	845
1942	128	929	1949	133	3, 943
1943	100	949	1950 (first 6 months)	72	2, 066
1944	76	959			
1945	68	1, 028	Total	919	14, 255
1946	59	1, 775			

Source: Hall, James K. The Taxation of Corporate Surplus Accumulations. Washington, U. S. Government Printing Office, 1952, table 15, p. 109. [Study prepared for the Joint Committee on the Economic Report.]
Internal Revenue Service.

TABLE 33.—*Corporation income tax rates, 1909–54*

Calendar year	Reduced rates on small corporations	General rate (percent)
1909–13	$5,000 exemption	1
1913–15	None after Mar. 1, 1913	1
1916		2
1917		6
1918	$2,000 exemption	12
1919–21	do	10
1922–24	do	12½
1925	do	13
1926–27	do	13½
1928	$3,000 exemption	12
1929	do	11
1930–31	do	12
1932–35	None	13¾
1936–37	Graduated normal tax ranging from—	
	First $2,000	8
	Over $40,000	15
	Graduated surtax on undistributed profits ranging from	7–27
1938–39	First $25,000	12½–16
	Over $25,000	[1] 19
1940	First $25,000	14. 85–18. 7
	$25,000 to $31, 964.30	38. 3
	$31,964.30 to $38,565.89	36. 9
	Over $38,565.89	24
1941	First $25,000	21–25
	$25,000 to $38,461.54	44
	Over $38,461.54	31
1942–45	First $25,000	25–29
	$25,000 to $50,000	53
	Over $50,000	40
1946–49	First $25,000	21–25
	$25,000 to $50,000	53
	Over $50,000	38
1950	Normal tax 23; Surtax (over $25,000 surtax exemption) 19	42
1951	Normal tax 28¾; Surtax (over $25,000 surtax exemption) 22	50¾
1952–55	Normal tax 30; Surtax (over $25,000 surtax exemption) 22	52
1956	Present law [2]— Normal tax 26. 23; Surtax (over $25,000 surtax exemption) 22	48. 23
1957	Normal tax 25; Surtax (over $25,000 surtax exemption) 22	47

[1] Less adjustments: 14.025 percent of dividends received and 2½ percent of dividends paid.
[2] Provides reduction in rates effective Apr. 1, 1956, to 25 percent first $25,000 and 47 percent over $25,000. Rates computed to show effect of prorating income earned before and after Apr. 1.

TABLE 34.—*Effective rates of corporation income tax at selected taxable income levels, 1946–57* [1]

[Percent]

Taxable income	1946–49	1950	1951	1952–55	1956 [2]	1957 [2]
$5,000	21.00	23.00	28.75	30.00	26.23	25.00
$10,000	22.00	23.00	28.75	30.00	26.23	25.00
$25,000	23.00	23.00	28.75	30.00	26.23	25.00
$50,000	38.00	32.50	39.75	41.00	37.23	36.00
$75,000	38.00	35.67	43.42	44.67	40.90	39.67
$100,000	38.00	37.25	45.25	46.50	42.73	41.50
$250,000	38.00	40.10	48.55	49.80	46.03	44.80
$500,000	38.00	41.05	49.65	50.90	47.13	45.90
$1,000,000	38.00	41.53	50.20	51.45	47.68	46.45
$10,000,000	38.00	41.95	50.70	51.95	48.18	46.95
$100,000,000	38.00	42.00	50.74	51.99	48.23	46.99

1 Excluding excess-profits tax.
2 Assuming reduction of normal tax to 25 percent on Apr. 1, 1956.

TABLE 35.—*Schedule of tax payments for calendar-year corporations under 1950 law (1949–54) and under Revenue Act of 1954 (1955–59)*

[Percent of tax liability due in each installment]

Income year	Income year		Following year				Total
	September	December	March	June	September	December	
1949			25	25	25	25	100
1950			30	30	20	20	100
1951			35	35	15	15	100
1952			40	40	10	10	100
1953			45	45	5	5	100
1954			50	50	0	0	100
1955 [1]	5	5	45	45			100
1956 [1]	10	10	40	40			100
1957 [1]	15	15	35	35			100
1958 [1]	20	20	30	30			100
1959 [1]	25	25	25	25			100

1 Applicable to tax liability, in excess of $100,000.

TABLE 36.—*Corporation tax payment calendar, 1959 and thereafter, under Revenue Act of 1954*

[Calendar-year corporations]

Taxable income	Tax liability [1]	Tax payment calendar			
		September of taxable year	December of taxable year	March of following year	June of following year
$25,000	$7,500			$3,750	$3,750
$50,000	20,500			10,250	10,250
$100,000	46,500			23,250	23,250
$181,731	100,000			50,000	50,000
$250,000	124,500	$18,625	$18,625	43,625	43,625
$500,000	254,500	51,125	51,125	76,125	76,125
$1,000,000	514,500	116,125	116,125	141,125	141,125
$10,000,000	5,194,500	1,286,125	1,286,125	1,311,125	1,311,125
$100,000,000	51,994,500	12,986,125	12,986,125	13,011,125	13,011,125
	Percent of annual tax liability				
$25,000	100.0			50.0	50.0
$50,000	100.0			50.0	50.0
$100,000	100.0			50.0	50.0
$181,731	100.0			50.0	50.0
$250,000	100.0	15.0	15.0	35.0	35.0
$500,000	100.0	20.1	20.1	29.9	29.9
$1,000,000	100.0	22.6	22.6	27.4	27.4
$10,000,000	100.0	24.8	24.8	25.2	25.2
$100,000,000	100.0	25.0	25.0	25.0	25.0

1 30 percent normal tax and 22 percent surtax.

TABLE 37.—*Selected corporate business deductions, all corporations, 1946–52*

[Millions of dollars]

Deduction	1946	1947	1948	1949	1950	1951	1952
Compensation of officers	$5,143.1	$6,026.4	$6,733.3	$6,743.0	$7,606.8	$8,122.0	$8,430.0
Interest paid	2,251.0	2,501.4	2,758.7	3,045.1	3,211.9	3,700.5	5,013.2
Taxes paid	5,830.5	6,892.9	7,481.7	8,361.3	9,013.2	11,030.8	11,696.8
Contributions or gifts	213.9	241.2	239.3	222.6	252.4	343.0	398.6
Depletion	798.9	1,210.3	1,711.3	1,476.2	1,709.3	2,085.1	2,126.5
Depreciation	4,201.7	5,220.1	6,298.6	7,190.5	7,858.1	8,829.0	9,604.4
Amortization	64.5	58.9	38.9	30.6	43.3	291.9	831.3
Advertising	2,408.3	3,032.2	3,466.0	3,772.7	4,097.0	4,552.9	5,026.8
Amounts contributed under pension plans, etc.[1]	834.6	1,038.3	1,153.5	1,216.1	1,660.9	2,326.9	2,551.8 [2] 630.4
Other [3]	5,892.1	7,338.4	8,062.8	7,998.7	8,371.3	9,709.7	10,493.6

[1] Deductions claimed under sec. 23 (p) of the Internal Revenue Code for amounts contributed by employers under pension, annuity, stock-bonus, or profit-sharing plans, or other deferred compensation plans.
[2] Contributions under employee welfare plans.
[3] Includes bad debts, repairs, and rent paid on business property.

Source: Internal Revenue Service, Statistics of Income, pt. 2.

TABLE 38.—*Corporate depletion deductions by total assets classes, 1946–52* [1]

[Thousands of dollars]

Assets classes	1946	1947	1948	1949	1950	1951	1952
Under $50,000	$3.3	$3.9	$4.9	$3.7	$4.0	$3.5	$3.1
$50,000 and under $100,000	3.7	4.6	5.5	4.0	4.4	3.7	5.2
$100,000 and under $250,000	10.8	14.7	16.1	11.9	12.6	12.1	13.5
$250,000 and under $500,000	12.8	18.9	21.4	16.1	17.1	21.4	21.2
$500,000 and under $1,000,000	23.2	31.8	40.8	31.4	31.5	41.4	35.1
$1,000,000 and under $5,000,000	71.3	108.3	126.1	101.0	120.8	160.8	150.3
$5,000,000 and under $10,000,000	38.3	54.3	72.5	57.5	68.5	83.8	85.7
$10,000,000 and under $50,000,000	130.7	165.5	245.2	213.1	278.9	318.9	297.7
$50,000,000 and under $100,000,000	38.6	85.7	89.7	92.8	115.2	120.8	131.2
$100,000,000 or more	445.0	713.8	1,076.5	895.1	1,038.8	1,299.3	1,370.0
Total	777.7	1,201.4	1,698.9	1,426.5	1,691.8	2,065.8	2,112.9
	Percentage distribution						
Under $50,000	0.4	0.3	0.3	0.3	0.2	0.2	0.1
$50,000 and under $100,000	.5	.4	.3	.3	.3	.2	.2
$100,000 and under $250,000	1.4	1.2	.9	.8	.7	.6	.6
$250,000 and under $500,000	1.7	1.6	1.3	1.1	1.0	1.0	1.0
$500,000 and under $1,000,000	3.0	2.6	2.4	2.2	1.9	2.0	1.7
$1,000,000 and under $5,000,000	9.2	9.0	7.4	7.1	7.1	7.8	7.1
$5,000,000 and under $10,000,000	4.9	4.5	4.3	4.0	4.1	4.1	4.1
$10,000,000 and under $50,000,000	16.8	13.8	14.4	14.9	16.5	15.4	14.1
$50,000,000 and under $100,000,000	5.0	7.1	5.3	6.5	6.8	5.8	6.2
$100,000,000 or more	57.2	59.4	63.4	62.7	61.4	62.9	64.8
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

[1] All returns with balance sheets.

NOTE.—Detail may not add to totals because of rounding.

Source: Internal Revenue Service, Statistics of Income, pt. 2.

TABLE 39.—*Corporate depletion deductions and net income by total assets classes, 1952* [1]

[Dollar amounts in millions]

Assets classes	Net income [2]	Depletion deductions	Depletion deductions as percent of net income
Under $50,000	$382.5	$2.6	0.7
$50,000 under $100,000	577.0	4.7	.8
$100,000 under $250,000	1,364.9	11.2	.8
$250,000 under $500,000	1,336.0	17.5	1.3
$500,000 under $1,000,000	1,644.7	27.4	1.7
$1,000,000 under $5,000,000	4,716.4	129.2	2.7
$5,000,000 under $10,000,000	2,319.1	64.6	2.8
$10,000,000 under $50,000,000	6,105.7	250.9	4.1
$50,000,000 under $100,000,000	2,806.5	122.4	4.4
$100,000,000 or more	19,105.5	1,350.5	7.1
Total	40,358.3	1,980.9	4.9

[1] Returns with balance sheets and net income.
[2] Compiled receipts less compiled deductions as shown in Statistics of Income.

Source: Internal Revenue Service, Statistics of Income, pt. 2.

TABLE 40.—*Corporate depreciation and accelerated amortization deductions, all returns, 1941–54*

[Dollar amounts in millions]

Year	Corporate profits before taxes and deductions for depreciation and amortization [1]	Depreciation	Accelerated amortization	Total depreciation and accelerated amortization	
				Amount	Percent of net profits
1941	$20,554	$3,765	$114	$3,879	18.9
1942	27,714	3,914	411	4,325	15.6
1943	32,733	3,916	691	4,607	14.1
1944	31,478	3,950	981	4,931	15.7
1945	27,273	3,977	1,951	5,928	21.7
1946	29,665	4,202	64	4,266	14.4
1947	36,894	5,220	59	5,279	14.3
1948	40,926	6,299	39	6,338	15.5
1949	35,608	7,191	31	7,222	20.3
1950	50,733	7,858	43	7,901	15.6
1951	52,920	8,829	292	9,121	17.2
1952	49,171	9,604	831	10,436	21.2
1953	49,962	(2)	(2)	11,688	23.4
1954	47,163	(2)	(2)	13,121	27.8

[1] For the period 1941–52, equals compiled net profits as reported in Statistics of Income. 1953–54 data are from Department of Commerce and differ in certain respects from income-tax data.
[2] Not available.

Source: Internal Revenue Service, Statistics of Income, pt. 2, Department of Commerce.

TABLE 41.—*Distribution of corporate depreciation and amortization deductions by total assets classes, 1952* [1]

[Dollar amounts in millions]

Assets classes	Amount			Percent of total		
	Depreciation	Amortization	Total	Depreciation	Amortization	Total
Under $50,000	$248.3	$0.5	$248.8	2.6	0.1	2.4
$50,000, under $100,000	276.0	.8	276.8	2.9	.1	2.7
$100,000, under $250,000	608.5	2.0	610.5	6.4	.2	5.9
$250,000, under $500,000	526.4	3.8	530.2	5.5	.5	5.1
$500,000, under $1,000,000	553.9	5.3	559.2	5.8	.8	5.4
$1,000,000, under $5,000,000	1,203.0	27.1	1,230.1	12.7	3.3	11.9
$5,000,000, under $10,000,000	495.9	27.0	522.9	5.2	3.3	5.1
$10,000,000, under $50,000,000	1,142.6	92.9	1,235.5	12.0	11.2	12.0
$50,000,000, under $100,000,000	529.1	56.4	585.5	5.6	6.8	5.7
$100,000,000, or more	3,908.8	611.7	4,520.5	41.2	73.9	43.8
Total	9,492.7	827.3	10,319.9	100.0	100.0	100.0

[1] All returns with balance sheets.

NOTE.—Detail may not add to totals because of rounding.

Source: Internal Revenue Service, Statistics of Income, pt. 2.

TABLE 42.—*Corporate depreciation and amortization deductions as a percent of net income by total assets classes, 1952* [1]

[Dollar amounts in millions]

Assets classes	Net income [2]	Depreciation deductions	Amortization deductions	Total amortization and depreciation deductions	Total amortization and depreciation deductions as a percent of net income
Under $50,000	$382.5	$137.3	$0.3	$137.6	36.0
$50,000 and under $100,000	577.0	198.2	.6	198.7	34.4
$100,000 and under $250,000	1,364.9	478.4	1.5	479.9	35.2
$250,000 and under $500,000	1,336.0	432.7	2.4	435.1	32.6
$500,000 and under $1,000,000	1,644.7	457.9	4.9	462.7	28.1
$1,000,000 andunder $5,000,000	4,716.4	1,014.7	25.1	1,039.8	22.0
$5,000,000 and under $10,000,000	2,319.1	426.6	25.7	452.3	19.5
$10,000,000 and under $50,000,000	6,105.7	1,045.3	89.3	1,134.6	18.6
$50,000,000 and under $100,000,000	2,806.5	503.0	55.5	558.5	19.9
$100,000,000 or more	19,105.5	3,862.6	609.1	4,471.8	23.4
Total	40,358.3		814.5	9,371.1	23.2

[1] Returns with balance sheets and net income.
[2] Compiled receipts less compiled deductions as shown in Statistics of Income.

NOTE.—Detail may not add to totals because of rounding.

Source: Internal Revenue Service, Statistics of Income, pt. 2.

EXCISES

TABLE 43.—*Collections from excise taxes on liquor, tobacco, gasoline, retail sales, and general admissions, 1939–55*

[Dollar amounts in millions]

Fiscal year	Total excise tax collections	Liquor	Tobacco	Gasoline	Retail taxes	General admissions	Other
1939	$1,750	$588	$580	$207	----------	$18	$357
1940	1,867	624	608	226	----------	20	389
1941	2,381	820	698	343	----------	69	451
1942	3,124	1,048	781	370	$80	108	737
1943	3,794	1,423	924	289	165	138	855
1944	4,461	1,618	988	271	225	179	1,180
1945	5,945	2,310	932	406	424	301	1,572
1946	6,684	2,526	1,166	406	492	343	1,751
1947	7,283	2,475	1,238	434	514	393	2,229
1948	7,410	2,255	1,300	479	470	385	2,521
1949	7,579	2,211	1,322	504	449	386	2,707
1950	7,599	2,219	1,328	527	409	371	2,745
1951	8,703	2,547	1,380	569	457	346	3,404
1952	8,971	2,549	1,565	713	475	331	3,338
1953	9,946	2,781	1,655	891	496	313	3,810
1954	9,517	2,783	1,580	836	438	272	3,608
1955	9,201	2,726	1,571	947	292	106	3,559
	Percent of total						
1939	100.0	33.6	33.1	11.8	----------	1.0	20.4
1940	100.0	33.4	32.6	12.1	----------	1.1	20.8
1941	100.0	34.4	29.3	14.4	----------	2.9	18.9
1942	100.0	33.5	25.0	11.8	2.6	3.5	23.6
1943	100.0	37.5	24.4	7.6	4.3	3.6	22.5
1944	100.0	36.3	22.1	6.1	5.0	4.0	26.5
1945	100.0	38.9	15.7	6.8	7.1	5.1	26.4
1946	100.0	37.8	17.4	6.1	7.4	5.1	26.2
1947	100.0	34.0	17.0	6.0	7.1	5.4	30.6
1948	100.0	30.4	17.5	6.5	6.3	5.2	34.0
1949	100.0	29.2	17.4	6.6	5.9	5.1	35.7
1950	100.0	29.2	17.5	6.9	5.4	4.9	36.1
1951	100.0	29.3	15.9	6.5	5.3	4.0	39.1
1952	100.0	28.4	17.4	8.0	5.3	3.7	37.1
1953	100.0	28.0	16.6	9.0	5.0	3.1	38.3
1954	100.0	29.2	16.6	8.8	4.6	2.9	37.9
1955	100.0	29.6	17.1	10.3	3.2	1.2	38.7

NOTE.—Detail may not add to totals because of rounding.

Source: Treasury Bulletin.

TABLE 44.—*Excise tax collections by major sources, fiscal year 1955*

[Dollar amounts in millions]

Source	Collections: Amount	Collections: Percent of total
Alcohol taxes	$2,726.1	29.6
Tobacco taxes	1,570.6	17.1
Manufacturers' excises:		
Gasoline, lubricating oil, and diesel fuel [1]	1,041.3	11.3
Autos, trucks, tires, and parts	1,482.9	16.1
Electric, gas, and oil appliances (including refrigerators, air-conditioners, etc.)	88.9	1.0
Recreational items (radios, musical instruments, photographic, and sporting goods)	197.9	2.2
Other	90.1	1.0
Retailers' excises (furs, jewelry, luggage, and toilet preparations)	292.1	3.2
Communications	520.4	5.7
Transportation (persons, property, and oil)	638.5	6.9
Amusements (admissions, cabarets, club dues, bowling and billiards, coin-operated devices, wagering	213.5	2.3
Stamp taxes on financial transactions	105.3	1.1
Undistributed depositary receipts	114.7	1.2
All other	118.2	1.3
Total	9,200.5	100.0

[1] The tax on diesel fuel is not a manufacturers' excise but is included here because of its relationship to the gasoline tax.

Source: Treasury Bulletin.

STATE AND LOCAL

TABLE 45.—*Percentage distribution of State tax collections by major sources, 1902–55*

Year	Total, excluding unemployment compensation	General sales or gross receipts	Income			Motor fuels sales	Motor vehicle and operator licenses	Tobacco products sales	Alcoholic beverage sales and licenses	Death and gift	Property	Severance	Other
			Total	Individual	Corporation								
1902	100.0	--------	--------	--------	--------	--------	(2)	--------	6.4	(1)	52.6	--------	41.0
1913	100.0	--------	(1)	(1)	(1)	--------	1.7	--------	7.0	(1)	46.5	--------	44.8
1915	100.0	--------	0.5	(1)	(1)	--------	4.1	--------	5.7	7.9	50.5	--------	31.3
1919	100.0	--------	8.4	(1)	(1)	0.2	10.9	--------	2.4	7.7	39.9	--------	30.5
1922	100.0	--------	10.3	(1)	(1)	1.4	16.1	(1)	--------	7.0	36.7	--------	28.5
1923	100.0	--------	9.1	(1)	(1)	3.8	18.5	(1)	--------	7.4	34.6	--------	26.6
1924	100.0	--------	8.9	(1)	(1)	7.0	19.9	(1)	--------	6.9	30.9	--------	26.4
1925	100.0	--------	7.9	(1)	(1)	11.3	20.0	(1)	--------	6.6	27.5	(1)	26.7
1926	100.0	--------	9.1	(1)	(1)	12.8	19.7	(1)	--------	6.2	25.7	(1)	26.5
1927	100.0	--------	10.1	(1)	(1)	16.1	18.7	(1)	--------	6.6	23.0	(1)	25.5
1928	100.0	--------	10.5	(1)	(1)	17.3	18.4	(1)	--------	7.3	21.7	(1)	24.8
1929	100.0	--------	10.5	(1)	(1)	22.1	17.8	(1)	--------	7.6	17.9	(1)	24.1
1930	100.0	(2)	11.0	(1)	(1)	23.5	16.9	0.6	--------	8.7	16.4	(1)	22.9
1931	100.0	0.4	9.8	4.2	5.6	26.3	16.8	.7	.1	9.2	18.2	1.3	17.2
1932	100.0	.4	8.1	3.9	4.2	27.9	17.7	1.0	.1	7.8	17.3	1.0	18.7
1933	100.0	.9	7.0	3.7	3.3	30.0	17.6	1.2	.6	7.4	16.5	.8	18.0
1934	100.0	8.7	6.5	4.0	2.5	28.5	15.4	1.3	4.1	4.7	13.8	1.1	15.9
1935	100.0	12.8	7.2	4.8	2.4	27.8	14.6	1.3	6.4	4.5	11.2	1.2	13.0
1936	100.0	13.9	10.2	5.9	4.3	26.2	13.8	1.7	6.3	4.5	8.7	1.3	13.4
1937	100.0	14.4	11.8	6.6	5.2	24.0	11.6	1.8	7.3	3.9	9.7	1.6	13.9
1938	100.0	14.3	12.2	6.9	5.3	24.8	11.5	1.8	7.2	4.5	7.8	1.9	14.0
1939	100.0	14.3	10.7	6.4	4.3	26.0	11.8	1.9	7.4	4.3	8.4	1.5	13.7
1940	100.0	15.1	10.9	6.2	4.7	25.3	11.7	2.9	7.7	3.4	7.8	1.6	13.6
1941	100.0	16.0	11.7	6.2	5.5	25.3	12.0	2.9	7.6	3.3	7.4	1.5	12.3
1942	100.0	16.2	13.3	6.4	6.9	24.1	11.0	3.3	8.0	2.8	6.8	1.6	12.9
1943	100.0	16.9	16.0	7.4	8.6	19.6	10.4	3.6	8.5	2.8	6.5	1.9	13.8
1944	100.0	17.7	18.7	7.8	10.9	16.8	9.7	3.9	7.9	2.8	6.0	1.7	14.8
1945	100.0	17.9	18.6	8.2	10.4	16.0	9.5	3.3	8.5	3.1	6.4	1.9	14.8
1946	100.0	18.2	16.8	7.9	8.9	18.0	8.9	4.0	9.5	2.9	5.0	1.8	14.9
1947	100.0	20.3	15.2	7.2	8.0	19.4	9.3	4.2	8.3	2.9	4.5	1.6	14.3
1948	100.0	21.9	16.1	7.4	8.7	18.7	8.8	5.0	7.4	2.7	4.1	1.9	13.4
1949	100.0	21.8	16.7	8.0	8.7	18.4	9.0	5.3	6.8	2.4	3.8	2.7	13.1
1950	100.0	21.0	16.5	9.1	7.4	19.5	9.5	5.2	6.3	2.1	3.9	2.7	13.3
1951	100.0	22.4	16.7	9.0	7.7	19.1	9.4	4.8	6.1	2.2	3.9	2.5	12.9
1952	100.0	22.6	17.8	9.3	8.5	19.0	9.4	4.5	5.3	2.1	3.7	2.8	12.8

1953	100.0	23.1	16.9	9.2	7.7	19.1	9.6	4.4	5.2	2.1	3.5	2.7	13.4
954	100.0	22.9	16.0	9.0	7.0	20.0	9.9	4.2	4.9	2.2	3.5	2.8	13.6
1955 [3]	100.0	22.8	15.7	9.3	6.4	20.3	10.2	4.0	4.8	2.2	3.6	2.6	13.8

[1] Distribution not available. [2] Less than 0.05 percent. [3] Preliminary.

Source: Analysis Staff, Tax Division, U. S. Treasury Department, Overlapping Taxes in the United States, p. 21.
1902, 1913: Bureau of the Census, based on wealth, public debt, and taxation.
1915–41, 1943, 1945, 1947: Bureau of the Census, Historical Review of State and Local Government Finances, June 1948.
1942, 1944, 1946, 1948, 1950: Bureau of the Census, Revised Summary of State Government Finances, 1942–50.
1949, 1951: Bureau of the Census, Compendium of State Government Finances in 1949, 1951.
1952–55: Bureau of the Census, State tax collections.

TABLE 46.—*Local tax collections, by major sources, 1902–54* [1]

[Dollar amounts in millions]

Year	Total	Property tax	All non-property taxes	Sales taxes	Income taxes: Total	Income taxes: Individual	Income taxes: Corporation	All other
1902	$704	$624	$80					
1913	1,308	1,192	116					
1929	4,485	4,344	141					
1932	4,468	4,353	115					
1942	4,624	4,273	352	$133	$30	$27	$3	$189
1943	4,713	4,386	327	(2)	(2)	(2)	(2)	(2)
1944	4,791	4,450	341	(2)	(2)	(2)	(2)	(2)
1945	4,886	4,526	360	156	31	26	5	173
1946	5,157	4,737	420	183	38	33	5	199
1947	5,833	5,246	587	306	43	37	6	238
1948	6,599	5,850	749	400	51	44	7	298
1949	7,414	6,566	848	451	58	51	7	339
1950	7,984	7,042	942	484	71	64	7	387
1951	8,621	7,580	1,040	551	75	68	7	414
1952	9,466	8,282	1,185	627	93	85	8	465
1953	10,356	9,010	1,346	718	103	96	7	523
1954	10,978	9,577	1,401	703	129	122	7	569
	Percentage distribution							
1902	100	89	11					
1913	100	91	9					
1929	100	97	3					
1932	100	97	3					
1942	100	92	8	3	1	1	(3)	4
1943	100	93	7	(2)	(2)	(2)	(2)	(2)
1944	100	93	7	(2)	(2)	(2)	(2)	(2)
1945	100	93	7	3	1	1	(3)	4
1946	100	92	8	4	1	1	(3)	4
1947	100	90	10	5	1	1	(3)	4
1948	100	89	11	6	1	1	(3)	5
1949	100	89	11	6	1	1	(3)	5
1950	100	88	12	6	1	1	(3)	5
1951	100	88	12	6	1	1	(3)	5
1952	100	87	13	7	1	1	(3)	5
1953	100	87	13	7	1	1	(3)	5
1954	100	87	13	6	1	1	(3)	5

[1] Includes Washington, D. C.
[2] Distribution not available.
[3] Less than 0.5 percent.

NOTE.—Detail may not add to totals because of rounding.

Source: 1902, 1932: Bureau of the Census, Historical Review of State and Local Government Finances, June 1948.
1942, 1945–52: Bureau of the Census, Summary of Governmental Finances in 1952, November 2, 1953.
1913, 1929, 1943 and 1944: Bureau of the Census estimates.
Analysis Staff, Tax Division, U. S. Treasury Department, Overlapping Taxes in the United States, p. 29 and Bureau of the Census, Summary of Governmental Finances in 1954.

TABLE 47.—*Percentages of tax revenue obtained from various types of taxes in the several States, 1955: Frequency distribution*

Percentage range	General sales	Income			Automotive			Tobacco	Liquor [2]	Death and gift	Property
		Individual	Corporation	Total income	Motor vehicle licenses [1]	Motor fuels	Total automotive				
Under 5		5	8	1	5			22	31	44	22
5 to 10	1	8	11	5	17	1		18	15	3	16
10 to 15		8	6	10	20	3		1	2		2
15 to 20	2	2	3	6	3	10	2				1
20 to 25	4	4		3	3	16	5				1
25 to 30	7	1		4		14	6				
30 to 40	12	3		2		3	24				1
40 to 50	[3] 5			3		1	9				
Over 50	[4] 1						2				
Total	32	[5] 31	[5] 28	34	48	48	48	41	48	47	[6] 43

[1] Includes motor vehicle operators' licenses.
[2] Includes both excises and licenses.
[3] West Virginia figure includes collections from both the retail sales and business and occupation taxes.
[4] Washington figure includes collections from both the retail sales and business and occupation taxes.
[5] 4 States (Alabama, Louisiana, Missouri, and New Mexico) report combined corporation and individual income tax revenues and these are tabulated by the Bureau of the Census as individual income tax revenues. In the frequency distribution for individual income taxes, New Mexico falls in the under 5 percent group, Louisiana in the 5 to 10 percent group, and Alabama and Missouri in the 10 to 15 percent group.
[6] At least 20 States have relinquished the property tax to their local units or retain it only as a selective or incidental tax. Property tax revenues as reported by the Bureau of the Census include not only general property taxes but taxes on selected types of property such as motor vehicles, certain intangibles, and particular classes of utility property.

Source: Derived from Bureau of the Census, State Tax Collections in 1955, Aug. 26, 1955.

TABLE 48.—*State and local government debt and interest payments, 1902–54*

[In billions of dollars]

Fiscal year	Gross debt			Annual interest payments		
	Total	State	Local	Total	State	Local
1902	$2.2	$0.3	$1.9	$0.1	(1)	$0.1
1912	4.5	.4	4.1	[2] 0.2	(1)	.2
1922	10.3	1.2	9.1	(3)	(3)	(3)
1932	19.6	2.9	16.7	.8	$0.1	.7
1942	19.7	3.2	16.5	.7	.1	.6
1945	16.6	2.4	14.2	.6	.1	.5
1947	16.8	3.0	13.8	.5	.1	.4
1948	18.7	3.7	15.0	.5	.1	.5
1949	20.9	4.0	16.9	.6	.1	.5
1950	24.2	5.4	18.8	.6	.1	.5
1951	27.0	6.4	20.7	.6	.1	.5
1952	30.1	6.9	23.2	.7	.1	.6
1953	33.8	7.8	26.0	.8	.2	.6
1954	38.9	9.6	29.3	.9	.2	.7

[1] Less than $0.05 billion.
[2] Data for 1913.
[3] Not available.

Source: Statistical Abstract of the United States, Bureau of the Census, Summary of Governmental Finances in 1954.

TABLE 49 (part 1).—*State individual income taxes: Personal exemptions and credits for dependents, July 1, 1955*

States	Personal exemption		Credit for dependents	Additional exemption on account of	
	Single	Married or head of family		Age	Blindness
Alabama	$1,500	$3,000	$300	----------	----------
Arizona	1,000	2,000	600	----------	[1] $500
Arkansas	2,500	3,500	600	----------	----------
California	2,000	3,500	400	----------	[1] 500
Colorado	600	1,200	600	[1] $600	[1] 600
Delaware	600	1,200	600	[2] 600	[2] 600
Georgia	1,500	3,000	600	[1] 600	[1] 600
Idaho	700	1,500	[3] 200	----------	----------
Iowa [4]	12 (1,250)	24 (2,000)	12 (500)	----------	----------
Kansas	600	1,200	600	[1] 600	[1] 600
Kentucky [4]	20 (1,000)	40 (2,000)	10 (500)	[2] 10 (500)	[2] 10 (500)
Louisiana [5]	2,500 (50)	5,000 (100)	400 (8)	----------	----------
Maryland	800	1,600	[6] 800	[5] 1,000	[5] 1,000
Massachusetts [7]	2,000	2,500–4,000	400	----------	----------
Minnesota [4]	10 (1,000)	30 (2,000)	10 (333)	([8])	([8])
Mississippi	4,000	6,000	----------	----------	----------
Missouri	1,200	2,400	400	----------	----------
Montana	1,000	2,000	300	----------	----------
New Hampshire [9]	600	600	----------	----------	----------
New Mexico	1,500	2,500	200	----------	----------
New York	1,000	2,500	400	----------	----------
North Carolina	1,000	[10] 2,000	300	----------	1,000
North Dakota	600	1,500	600	[5] 600	----------
Oklahoma	1,000	2,000	500	----------	----------
Oregon [11]	500	1,000	500	([12])	[2] 500
South Carolina	1,000	2,000	400	----------	----------
Tennessee [9]	----------	----------	----------	----------	----------
Utah	600	1,200	600	----------	600
Vermont	500	1,000	500	[1] 500	[1] 500
Virginia	1,000	2,000	200	[1] 600	[1] 600
Wisconsin [4]	7 (700)	14 (1,320)	7 (560)	----------	----------
District of Columbia	4,000	[13] 4,500 or 8,000	500	----------	----------

1 An identical exemption is allowed for a spouse if separate returns are filed.
2 An identical exemption is allowed for a spouse.
3 In addition, a tax credit of $5 is allowed for each dependent.
4 Personal exemptions and credits for dependents are allowed in the form of tax credits which are deductible from the amount of tax. With respect to personal exemptions, the sum in parentheses is the exemption equivalent of the tax credit assuming that the exemption is deducted from the lowest brackets. With respect to the credits for dependents, the sum in parentheses is the amount by which the first dependent raises the level at which a married person or head of family becomes taxable.
5 The exemptions and credits for dependents are deductible from the lowest income bracket and are equivalent to the tax credits shown in parentheses.
6 An additional credit of $600 is allowed for each dependent 65 years of age or over.
7 The exemptions shown are those allowed against business income, including salaries and wages: A specific exemption of $2,000 for each taxpayer, and in the case of a joint return, the smaller of (1) $4,000 or (2) $2,000 plus the income of the spouse having the smaller income. In addition, a dependency exemption of $500 is allowed for a dependent spouse who has income from all sources of less than $2,000. For nonbusiness income (annuities, interest, and dividends), the exemption is the smaller of (1) $1,000 or (2) the unused portion of the exemption applicable to business inome. Married persons must file a joint return in order to obtain any nonbusiness income exemption. If either party to a joint return is 65 years of age, the exemption is increased from $1,000 to $1,500. No exemption is allowed against nonbusiness income if income from all sources for a single person exceeds $5,000 and for a married person exceeds $7,500.
8 An additional tax credit of $10 for single persons and $15 each for taxpayer and spouse is allowed for persons 65 years of age or over and for blind persons.
9 The tax applies only to interest and dividends.
10 An additional exemption of $1,000 is allowed a married woman with separate income.
11 A "hardship" exemption is allowed: for single persons, the amount by which $1,000 exceeds adjusted gross income, and for married persons, the amount by which $1,500 exceeds adjusted gross income.
12 A tax credit of $6 is allowed taxpayers and their spouses if 65 years of age or over.
13 The exemption is $4,500 if the spouse is a dependent. If both husband and wife file returns each is allowed a $4,000 exemption.

TABLE 49 (Pt. 2).—*State individual income taxes: Rates, July 1, 1955*

State	Net income after personal exemption	Rate	Special rates or features
		Percent	
Alabama	1st $1,000	1.5	A standard deduction is allowed.
	$1,001 to $3,000	3	
	$3,001 to $5,000	4.5	
	Over $5,000	5	
Arizona	1st $1,000	1	A standard deduction and an optional tax table are provided. Resident taxpayers have the option of using as a tax base Federal net income less Federal income tax and certain Federal credits.
	$1,001 to $2,000	1.5	
	$2,001 to $3,000	2	
	$3,001 to $4,000	2.5	
	$4,001 to $5,000	3	
	$5,001 to $6,000	3.5	
	$6,001 to $7,000	4	
	Over $7,000	4.5	
Arkansas	1st $3,000	1	A standard deduction is allowed.
	$3,001 to $6,000	2	
	$6,001 to $11,000	3	
	$11,001 to $25,000	4	
	Over $25,000	5	
California	1st $5,000	1	A standard deduction and an optional tax table are provided.
	$5,001 to $10,000	2	
	$10,001 to $15,000	3	
	$15,001 to $20,000	4	
	$20,001 to $25,000	5	
	Over $25,000	6	
Colorado	1st $1,000	1	A standard deduction and an optional tax table are provided. Surtax on intangible income over $600, 2 percent. For taxable year 1955 the tax is reduced by 20 percent.
	$1,001 to $2,000	1.5	
	$2,001 to $3,000	2	
	$3,001 to $4,000	2.5	
	$4,001 to $5,000	3	
	$5,001 to $6,000	4	
	$6,001 to $7,000	5	
	$7,001 to $8,000	6	
	$8,001 to $9,000	7	
	$9,001 to $10,000	8	
	$10,001 to $11,000	9	
	Over $11,000	10	
Delaware	1st $3,000	1	
	$3,001 to $4,000	2	
	$4,001 to $6,000	3	
	$6,001 to $8,000	4	
	$8,001 to $100,000	5	
	Over $100,000	6	
Georgia	1st $1,000	1	A standard deduction is allowed.
	$1,001 to $3,000	2	
	$3,001 to $5,000	3	
	$5,001 to $7,000	4	
	$7,001 to $10,000	5	
	Over $10,000	6	
Idaho	1st $1,000	1.5	A standard deduction is allowed. The tax is reduced by $5 for each dependent. A surtax of 7½ percent of computed tax is imposed for 1955 and 1956.
	$1,001 to $2,000	3	
	$2,001 to $3,000	4	
	$3,001 to $4,000	5	
	$4,001 to $5,000	6	
	Over $5,000	8	
Iowa	1st $1,000	.8	An optional tax table is provided.
	$1,001 to $2,000	1.6	
	$2,001 to $3,000	2.4	
	$3,001 to $4,000	3.2	
	Over $4,000	4	
Kansas	1st $2,000	1	A standard deduction is allowed.
	$2,001 to $3,000	2	
	$3,001 to $5,000	2.5	
	$5,001 to $7,000	3	
	Over $7,000	4	
Kentucky	1st $3,000	2	A standard deduction and an optional tax table are provided.
	$3,001 to $4,000	3	
	$4,001 to $5,000	4	
	$5,001 to $8,000	5	
	Over $8,000	6	
Louisiana	1st $10,000	2	A standard deduction is allowed.
	$10,000 to $50,000	4	
	Over $50,000	6	
Maryland	Ordinary income	2	A standard deduction and an optional tax table are provided.
	Investment income:		
	1st $500	2	
	Balance	5	
Massachusetts	Earned income and business income.	3.075	Rates include additional taxes: on all types of income, surtaxes of 23 percent of tax (3 percent permanent plus 20 percent for 1950–55); for 1951–54, 1 percent of earned and business income, and 3 percent of capital gains on intangibles.
	Interest and dividends, capital gains on intangibles.	7.38	
	Annuities	1.845	

TABLE 49 (Pt. 2).—*State individual income taxes: Rates, July 1, 1955*—Continued

State	Net income after personal exemption	Rate	Special rates or features
		Percent	
Minnesota	1st $1,000	1	A standard deduction and an optional tax table are provided. For taxable years 1949–58, a surtax of 5 percent of the tax before personal credit is imposed. For taxable years 1955 and 1956, an additional surtax of 5 percent is levied. An additional $5 tax is imposed on each person required to file a return.
	$1,001 to $2,000	2	
	$2,001 to $3,000	3	
	$3,001 to $4,000	4	
	$4,001 to $5,000	5	
	$5,001 to $7,000	6	
	$7,001 to $9,000	7	
	$9,001 to $12,500	8	
	$12,501 to $20,000	9	
	Over $20,000	10	
Mississippi	1st $5,000	2	A standard deduction is allowed. A surtax of 14 percent of the tax is imposed for the period Apr. 1, 1955, to June 30, 1956.
	$5,001 to $10,000	3	
	$10,001 to $15,000	4	
	$15,001 to $25,000	5	
	Over $25,000	6	
Missouri	First $1,000	1	A standard deduction and an optional tax table are provided. The rates apply to total income not merely to the portion of income falling within a given bracket, but as a result of the following tax credits, the schedule in effect is a bracket rate schedule: $1,001 to $2,000 — $5 $2,001 to $3,000 — 15 $3,001 to $5,000 — 30 $5,001 to 7,000 — 55 $7,001 to $9,000 — 90 Over $9,000 — 135
	$1,001 to $2,000	1.5	
	$2,001 to $3,000	2	
	$3,001 to $5,000	2.5	
	$5,001 to $7,000	3	
	$7,001 to $9,000	3.5	
	Over $9,000	4	
Montana	First $2,000	1	A standard deduction is allowed.
	$2,001 to $4,000	2	
	$4,001 to $6,000	3	
	Over $6,000	4	
New Hampshire	Interest and dividends (excluding interest on savings deposits).	(1)	The rate for 1954 is 4.64 percent.
New Mexico	First $10,000	1	
	$10,001 to $20,000	2	
	$20,001 to $100,000	3	
	Over $100,000	4	
New York	First $1,000	2	A standard deduction is allowed. Capital gains are taxed at ½ the regular rates. Income from unincorporated business is taxed at 4 percent.
	$1,001 to $3,000	3	
	$3,001 to $5,000	4	
	$5,001 to $7,000	5	
	$7,001 to $9,000	6	
	Over $9,000	7	
North Carolina	1st $2,000	3	A standard deduction is allowed.
	$2,001 to $4,000	4	
	$4,001 to $6,000	5	
	$6,001 to $10,000	6	
	Over $10,000	7	
North Dakota	1st $3,000	1	
	$3,001 to $4,000	2	
	$4,001 to $5,000	3	
	$5,001 to $6,000	5	
	$6,001 to $8,000	7.5	
	$8,001 to $15,000	10	
	Over $15,000	11	
Oklahoma	1st $1,500	1	A standard deduction and an optional tax table are provided.
	$1,501 to $3,000	2	
	$3,001 to $4,500	3	
	$4,501 to $6,000	4	
	$6,001 to $7,500	5	
	Over $7,500	6	
Oregon	1st $500	2	A standard deduction and an optional tax table are provided. For tax years ending after Aug. 3, 1955, a surtax of 45 percent of the tax is imposed.
	$501 to $1,000	3	
	$1,001 to $2,000	4	
	$2,001 to $3,000	5	
	$3,001 to $4,000	6	
	$4,001 to $8,000	7	
	Over $8,000	8	
South Carolina	1st $2,000	2	A standard deduction is allowed.
	$2,001 to $4,000	3	
	$4,001 to $6,000	4	
	Over $6,000	5	
Tennessee	Interest and dividends.	6	Dividends from corporations having at least 75 percent of their property subject to the Tennessee ad valorem tax are taxed at 4 percent.

1 Average property tax rate.

TABLE 49 (Pt. 2).—*State individual income taxes: Rates, July 1, 1955*—Continued

State	Net income after personal exemption	Rate	Special rates or features
		Percent	
Utah	1st $1,000	1	A standard deduction is allowed.
	$1,001 to $2,000	2	
	$2,001 to $3,000	3	
	$3,001 to $4,000	4	
	Over $4,000	5	
Vermont	1st $1,000	2	A standard deduction and an optional tax table are provided.
	$1,001 to $3,000	4	
	$3,001 to $5,000	6	
	Over $5,000	7.5	
Virginia	1st $3,000	2	A standard deduction is allowed. Reductions in tax depending upon State revenue yield are allowed.
	$3,001 to $5,000	3	
	Over $5,000	5	
Wisconsin	1st $1,000	1	A standard deduction and an optional tax table are provided. A surtax of 20 percent of the tax is imposed for calendar years 1955 and 1956.
	$1,001 to $2,000	1.25	
	$2,001 to $3,000	1.5	
	$3,001 to $4,000	2.5	
	$4,001 to $5,000	3	
	$5,001 to $6,000	3.5	
	$6,001 to $7,000	4	
	$7,001 to $8,000	5	
	$8,001 to $9,000	5.5	
	$9,001 to $10,000	6	
	$10,001 to $11,000	6.5	
	$11,001 to $12,000	7	
	$12,001 to $13,000	7.5	
	$13,001 to $14,000	8	
	Over $14,000	8.5	
District of Columbia	1st $5,000	2.5	A standard deduction is allowed. Income from unincorporated business is taxed at 5 percent.
	$5,001 to $10,000	3	
	$10,001 to $15,000	3.5	
	Over $15,000	4	

Compiled by Treasury Department, analysis staff, Tax Division.

TABLE 50.—*State corporation net income taxes: Rates, Oct. 1, 1955*

State	Rate	Related provisions
Alabama	3 percent	
Arizona	1st $1,000, 1 percent; $1,001 to $2,000, 2 percent; $2,001 to $3,000, 2.5 percent; $3,001 to $4,000, 3 percent; $4,001 to $5,000, 3.5 percent; $5,001 to $6,000, 4.5 percent; over $6,000, 5 percent.	
Arkansas	1st $3,000, 1 percent; $3,001 to $6,000, 2 percent; $6,001 to $11,000, 3 percent; $11,001 to $25,000, 4 percent; over $25,000, 5 percent.	
California	4 percent	Minimum tax, $25.
Colorado	4 percent	Applicable to taxable years 1950–55. The permanent rate is 5 percent.
Connecticut	3.75 percent	Applicable to taxable years beginning in 1955 and 1956. Minimum tax: 1.9 mills per dollar of asset value, but not less than $20. After 1956: 3 percent, or 1.5 mills per dollar of asset value, but not less than $15.
Georgia	4 percent	
Idaho	1st $1,000, 1.5 percent; $1,001 to $2,000, 3 percent; $2,001 to $3,000, 4 percent; $3,001 to $4,000, 5 percent; $4,001 to $5,000, 6 percent; over $5,000, 8 percent.	A 7½ percent surtax imposed for taxable years beginning after Dec. 31, 1954, expires Dec. 31, 1956.
Iowa	3 percent	
Kansas	2 percent	
Kentucky	4.5 percent	
Louisiana	4 percent	A specific exemption of $3,000,000 prorated according to the proportion of total net income taxable in Louisiana, is allowed against net income.
Maryland	4.5 percent	

TABLE 50.—*State corporation net income taxes: Rates, Oct. 1, 1955*—Continued

State	Rate	Related provisions
Massachusetts	6.765 percent	Includes the basic 2.5 percent rate, a temporary additional tax of 3 percent, a permanent surtax of 3 percent of tax, and a temporary surtax of 20 percent of tax for 1950–56. Minimum tax, 1/20 of 1 percent of the fair value of capital stock.
Minnesota	7.3 percent	Includes the permanent 6 percent rate, the 5 percent surtax applicable to 1949–58, and an additional 1 percent applicable to 2 taxable years beginning after Dec. 1, 1954. Minimum tax, $15 (including a $5 filing fee).
Mississippi	1st $5,000, 2 percent; $5,001 to $10,000, 3 percent; $10,001 to $15,000, 4 percent; $15,001 to $25,000, 5 percent; over $25,000, 6 percent.	A 14 percent surtax is imposed for the period Apr. 1, 1955, to June 30, 1956.
Missouri	2 percent	
Montana	3 percent	Minimum tax, $5.
New Mexico	2 percent	
New York	5.5 percent plus tax on allocated subsidiary capital: 1st $50 million, 1/2 mill per dollar; next $50 million, 1/4 mill per dollar; over $100 million, 1/8 mill per dollar.	The alternative taxes are: (1) 1 mill on each dollar of business and investment capital, or (2) 5 1/2 percent of 30 percent of net income plus compensation paid to officers and holders of more than 5 percent of capital stock, less $15,000 and any net loss, or (3) $25, whichever is greatest; plus the tax on allocated subsidiary capital.
North Carolina	6 percent	
North Dakota	1st $3,000, 3 percent; $3,001 to $8,000, 4 percent; $8,001 to $15,000, 5 percent; over $15,000, 6 percent.	
Oklahoma	4 percent	
Oregon	8 percent	Minimum tax, $10.
Pennsylvania	5 percent	Applicable to taxable years 1951–57.
Rhode Island	do	Applicable to taxable years 1951–55. The permanent rate is 4 percent. Minimum tax: 40 cents per $100 on corporate excess.
South Carolina	5 percent	Minimum tax: 3 percent of entire net income plus compensation paid to officers and holders of more than 5 percent of capital stock, less $6,000 and deficit for year.
Tennessee	3.75 percent	
Utah	4 percent	Minimum tax: 1/20 of 1 percent of the value of tangible property within the State, but not less than $10.
Vermont	5 percent	Minimum tax, $25.
Virginia	5 percent	Annual tax reductions based on tax collections are provided. For taxable year 1955, no reduction was allowed.
Wisconsin	Normal tax: 1st $1,000, 2 percent; $1,001 to $2,000, 2.5 percent; $2,001 to $3,000, 3 percent; $3,001 to $4,000, 4 percent; $4,001 to $5,000, 5 percent; $5,001 to $6,000, 6 percent; over $6,000, 7 percent.	
District of Columbia	5 percent	

Compiled by Treasury Department, analysis staff, Tax Division.

TABLE 51:—*Effect of deductibility*[1] *on combined Federal and State individual income-tax marginal rates,*[2] *at selected surtax net income levels and 1953 tax rates*[1]

[Percent]

Surtax net income	Federal marginal rate	State marginal rate[3]	State does not allow deduction for Federal tax		State allows deduction for Federal tax	
			Combined Federal and State marginal rate	Percentage points added by State tax	Combined Federal and State marginal rate	Percentage points added by State tax
$20,000	62	10	65.80	3.80	63.54	1.54
$30,000	67	10	70.30	3.30	68.17	1.17
$50,000	77	10	79.30	2.30	77.57	.57
$100,000	90	10	91.00	1.00	90.11	.11
$200,000	92	10	92.80	.80	92.07	.07

[1] The Federal Government allows taxpayers to deduct State income taxes in computing net taxable income for Federal purposes. Approximately two-thirds of the income-tax States allow deduction of Federal tax in computing the State tax.

[2] The marginal rate is the rate applicable to an additional dollar of income.

[3] The top rate is as high as 10 percent in only 3 States (in 1 of these it is 11 percent); in 2 States the top rate is 8 percent and in 1 State 8.5 percent; in 23 States it is no higher than 7 percent.

NOTE.—The effect of deductibility is illustrated only for net incomes beginning at $20,000 since most low-income taxpayers do not itemize deductions but use the standard deduction for both Federal and State income-tax purposes.

Source: Analysis Staff, Tax Division, U. S. Treasury Department, Overlapping Taxes in the United States, p. 43.

TABLE 52.—*State sales taxes: Types and rates, July 1, 1955*

State	Type of tax [1]	Rates on retail sales (percent): Tangible personal property	Selected services: Amusements	Selected services: Restaurants	Selected services: Public utilities	Rates on other sales and services
Alabama	Retail sales	3	3	3	--------	Automobiles (including trucks, trailers, tractors, buses, motorcycles), 1 percent.
Arizona [2]	do	2	2	1	1	Wholesale sales of feed to poultry and livestock producers, and meat packing, ¼ percent; advertising, printing, and publishing, contracting, extracting and processing minerals and timber, 1 percent; hotel, apartment, and office rentals; storage, credit, and collection agencies, 2 percent.
Arkansas [3]	do	2	2	2	2	Printing and photography; hotel, roominghouse, and tourist court rentals, 2 percent.
California	do	3	--------	3	--------	
Colorado [4]	do	2	--------	2	2	
Connecticut [5]	do	3	--------	3	--------	
Florida [6]	do	3	3	3	--------	Rental of living quarters (for less than 6 months), 3 percent.
Georgia [7]	do	3	3	3	3	Transient lodging (for less than 90 consecutive days), 3 percent.
Illinois [8]	do	2½	--------	2½	--------	
Indiana	Gross income.	½	1	½	1	Dry cleaning and laundering, ½ percent; all other income, 1 percent, except income received from wholesaling, display advertising, and industrial processing, ¼ percent.
Iowa [3] [9]	Retail sales	2½	2½	2½	2½	New motor vehicles, trailers, and accessories, 2 percent.
Kansas [3]	do	2	2	2	2	
Louisiana	do	2	2	2	--------	Hotels, laundry and dry cleaning, automobile and cold storage, printing, and repair services to tangible personal property, 2 percent.
Maine [10]	do	2	--------	2	2	
Maryland [11]	do	2	--------	--------	2	
Michigan [12]	do	3	--------	3	3	
Mississippi [2] [14]	General sales.	3	--------	3	3	Wholesaling, one-eighth of 1 percent; sales of tractors to farmers and of pasteurized milk by pasteurizers, 1 percent; contracting, when gross income from contracts exceeds $3,000, 1½ percent; automobiles, trucks, and truck tractors, and bus and taxicab fares, 2 percent; extracting or producing for sale certain natural resource products, and miscellaneous businesses (including cotton gins and warehouses, hotels and tourist courts, laundry and dry cleaning, meat curing, parking lots, photography, storage, termite or pest control services, and specified repair services) 3 percent; whisky, wholesale and retail, 5 percent.
Missouri [3]	Retail sales	2	2	2	2	
Nevada	do	2	--------	2	--------	
New Mexico [7]	Gross receipts.	2	2	2	2	Automobiles (including trucks, tractors, motorcycles), 1 percent; manufacturing, ¼ percent; wholesaling, ⅛ percent; extracting (other than gas, oil, and coal) and processing natural resource products, ½ percent; oil and gas production, 2.14 percent (including the ⅛ percent regulatory tax); cutting timber, ¼ percent; contracting, real estate brokers, factors, agents, professional and personal services (but not including wages and salaries) and miscellaneous businesses, 2 percent.
North Carolina	General sales	3	(15)	3	--------	Wholesaling, 1/20 percent; motor vehicles, airplanes, 1 percent ($80 maximum, transient lodging, 3 percent).

See footnotes at end of table, p. 187.

TABLE 52.—*State sales taxes: Types and rates, July 1, 1955*—Continued

State	Type of tax [1]	Rates on retail sales (percent)				Rates on other sales and services
		Tangible personal property	Selected services			
			Amusements	Restaurants	Public utilities	
North Dakota [3]	Retail sales	2	2	2	2	
Ohio	do	3		3		
Oklahoma [16]	do	2	2	2	2	Advertising (exclusive of newspapers, periodicals and billboards), printing, automobile storage, hotel, rooming house, and tourist camp rentals, 2 percent.
Pennsylvania [17]	do	1				
Rhode Island [3 18]	do	2		2	2	
South Carolina	do	3		3		Transient lodging, 3 percent.
South Dakota [3]	do	3	3	3	3	Rural telephone service, 2 percent.
Tennessee	do	3		3		Rentals of rooms to transients for less than 90 consecutive days, parking lots and storage of motor vehicles, 3 percent.
Utah [19]	do	2	2	2	2	
Washington	do	3⅓		3⅓		Transient lodging, 3⅓ percent (until June 30, 1957).
	Gross receipts.[20]	¼	½	¼		Manufacturing (except flour, which is taxed at ⅛ percent), ¼ percent; wholesaling, ¼ percent; extracting, printing, publishing, road and bridge construction, ¼ percent; professional and personal services rendered to persons (but not to personal property), and miscellaneous businesses, ½ percent.
West Virginia	Retail sales	2	2	2		All services except personal, professional, and public utilities, 2 percent.
	Gross receipts.[21]	½	65/100	½	1.3-5.2	Manufacturing, 39/100 percent; wholesaling, 195/1000 percent; extracting, 1.3 to 7.8 percent; contracting, 2 percent; all service businesses not specifically taxed (excluding professional services and services rendered by an employee), 1 percent.
Wyoming	Retail sales	2	2	2	2	
District of Columbia [22]	do	2		2	2	Transient lodging, 3 percent. Food and beverages for off-premises consumption, 1 percent.

See footnotes at end of table, p. 187.

[1] Types of tax:
(1) Retail sales: Applies to sales of tangible personal property at retail or to final consumer, and generally, to specified services such as amusements, restaurant meals, hotel rooms, and public utility services.
(2) General sales: Applies to sales of tangible personal property at both wholesale and retail, and, in some cases, to specified services.
(3) Gross receipts: Applies to sales by manufacturer, wholesaler, and retailer, receipts from miscellaneous services and businesses, and, in some cases, to professional and personal services.
(4) Gross income: Applies to all types of business and personal income.
[2] Applies to all public utilities, including transportation of oil and gas by pipeline. In Mississippi, the rate on sales of industrial gas and electricity is 1 percent.
[3] The 2½ percent rate applies to the period July 1, 1955, to June 30, 1957. The permanent rate is 2 percent. Applies to all public utilities except transportation, in Missouri, to all except transportation of freight.
[4] Applies to gas, electricity, telephone, and telegraph.
[5] The 3 percent rate applies to the period July 1, 1953, to June 30, 1957. The permanent rate is 2 percent. Meals selling for less than $1 are exempt.
[6] Admissions under 40 cents are exempt. Electricity, gas, water, and communications are specifically exempt.
[7] Applies to all public utilities except water.
[8] The 2½ percent rate applies to the period July 1, 1955, to June 30, 1957. The permanent rate is 2 percent. Utilities are exempt from the sales tax, but are taxed at a 3 percent rate under a separate act.
[9] The 2½ percent rate applies to the period July 1, 1955, to June 30, 1957. The permanent rate is 2 percent. Sales of motor vehicles are specifically exempt from the sales tax but are subject to the use tax which is payable at the time of licensing the vehicle.
[10] Applies to electricity, gas, and water.
[11] Applies to electricity and gas. Sales of motor vehicles are exempt from the sales tax but are subject to a 2 percent titling tax.
[12] The tax applies to sales of electricity and gas.
[13] In addition to the retail sales tax, Michigan imposes a business receipts tax, at the rate of 65/100 of 1 percent (the public utility rate is 15/100 of 1 percent). The tax applies at all stages of production and distribution to persons and business firms (including professions and self-employed) engaged in production for gain or benefit. Wage earners and salaried employees are exempt. The base of the tax is gross receipts minus certain deductions. A minimum deduction equal to 50 percent of gross receipts is allowed. An exemption of $10,000 is also allowed. This exemption, in combination with the minimum deduction, exempts businesses with gross receipts of not more than $20,000. Whenever the payroll of a person subject to the tax under the business receipts tax act exceeds 50 percent of the gross receipts of such person, then an additional deduction of 10 percent of the gross receipts of such person, or ½ of the excess, whichever is smaller, may be taken in addition to the basic 50 percent deduction.
[14] Applies to billiard parlors and bowling alleys only. Admissions to theaters and other amusement places are subject to a special amusements tax.
[15] The tax on amusements is a license tax, based on gross receipts of amusement operators, which is levied at the rate applicable to retail sales under the sales tax.
[16] Sales of motor vehicles are specifically exempt, but a special excise tax of 2 percent is levied upon the transfer of ownership and the use of a vehicle registered in the State. Admissions to motion pictures are exempt. The tax applies to all public utilities except water, transportation of freight, and transportation of persons when the fare does not exceed 15 cents.
[17] Effective for the period Sept. 1, 1953, to Aug. 31, 1955.
[18] The rate is 2 percent for the period June 1, 1951, through May 31, 1956. The permanent rate is 1 percent.
[19] Specifically excluded are water, street-railway fares, and freight and express.
[20] A temporary surtax of 60 percent of the amount of tax is imposed for the period Nov. 1, 1951, to June 30, 1957. The rate on operators of mechanical devices is 20 percent in the case of games of skill, or a combination of skill and chance, and 40 percent on games of chance only. Wholesale sales of wheat, oats, corn, and barley are taxed at 1/100 percent.
[21] A 5 percent credit is allowed against the tax.
[22] Meals selling for 50 cents or less and transportation and communication services are exempt.

Compiled by Treasury Department, analysis staff, Tax Division.

TABLE 53.—*Municipal sales taxes,*[1] *Oct. 1, 1955*

City or county	Date of adoption	Rate	Taxable services	Major exemptions
		Percent		
Alabama:				
Jasper	1946	[2] 1		Exemptions allowed under State sales tax.[4]
Talladega	1953	[2] 1	Admissions	
Tuscaloosa County	1953	[2] 1	do	
Winfield	1951	[2] 1	do	
Colbert County	1949	[2] ½	Admissions (1 percent)	
Lauderdale County	1949	[2] 1	Admissions	
Florence	1949	[2,3] ½	Admissions (1 percent)	
Marion County	1949	[2] 1	Admissions	
Franklin County	1955	[2] 1	do	
California:				In addition to exemptions allowed under State sales tax,[5] some cities specifically exempt sales made to or by the State or its political subdivisions; sales of property to be used in connection with Federal, State, and local public works, sales of drinks and meals on common carriers; sales to common carriers of property to be used or consumed in operations outside the city.
40 cities (approximate)	1946–55	½		
140 cities (approximate)	1946–55	1		
1 city	1946	1½		
Colorado: Denver	1948	1	Local telephone service and intrastate telegraph services originating in city; gas, electric, and steam services; meals and cover charges.	In addition to exemptions allowed under State sales tax,[6] the city exempts sales of food (except restaurant meals) and prescription medicine. Sales under 44 cents are exempt (State tax exempts sales under 19 cents).
Illinois:[7] 400 cities (approximately)	1955	½		
Louisiana:				
Baton Rouge	1951	1	Services taxed under State sales tax.[8]	In addition to exemptions allowed under State sales tax,[9] the cities exempt sales to certain charitable and religious institutions. Sales under 13 cents are exempt under the integrated bracket system for city and State sales taxes. (State tax exempts sales under 25 cents.)
New Orleans	1938	1		
Jefferson Parish	1955	1		
Mississippi:[10] 32 cities	1950–55	[11] ½	Services taxed under State sales tax.[12]	In addition to exemptions allowed under States sales tax,[13] the cities exempt wholesale sales which are subject to State tax.
New Mexico: Albuquerque[14]	1955	[15] 1	Communications, transportation, contracting, amusements, other personal and professional services, but not salaries and wages.	In addition to exemptions allowed under the State gross receipts tax[16] municipal public utilities and transportation services are exempt.
New York:				
New York City	1934	3	Producing, fabricating, processing, and printing (excluding repair, alteration, and reconditioning) of tangible personal property; specified utility services.[17]	Sales under 17 cents (19 cents in New York City; 25 cents in Erie County); materials used in production or manufacturing; nonluxury foods and beverages; drugs and prescription medicines, eyeglasses, hearing aids, and artificial limbs; newspapers and periodicals; cigarettes; sales to or by religious, charitable, and educational institutions.
Niagara Falls	1950	2		
Poughkeepsie	1949	2		
Syracuse	1949	2		
Erie County	1947	1		
Monroe County	1951	2		
Auburn County	1954	1		
Virginia: Bristol	1950	2		Sales under 15 cents.

[1] Data shown here are not necessarily complete. Furthermore, this tabulation does not include the business license, occupation, or privilege taxes based on gross receipts which are commonly levied by municipalities, even though the rates in some cases are as high as 1 percent. Such taxes are similar in effect to retail sales taxes although different in form and legal incidence.

[2] In line with State practice, a lower rate is applied to sales of automotive vehicles. The rate is ¼ percent in all cases except Colbert County and the city of Florence where it is ⅛ percent, and in Tuscaloosa County, where it is ⅓ percent.

[3] The Lauderdale County rate in the city of Florence is ½ percent.

[4] Major exemptions are: sales of machinery, parts, and replacements used in mining, quarrying, compounding, processing, and manufacturing, seed and fertilizer, farm products sold by producer, milk sold by distributors, newspapers and publications, textbooks, and sales of specified commodities subject to State selective excises (cigarettes, motor fuels, and alcoholic beverages).

[5] Major exemptions are: sales of food for human consumption not served on premises of retailer, ice, newspapers, periodicals and publications, and sales of gasoline and gas, electricity, and water, which are otherwise taxed.

[6] Major exemptions are: sales of seed and feed, farm livestock, sales to Federal Government, State, and city, and to religious and charitable organizations, sales subject to State selective excises, and sales subject to Federal excise of more than 12½ percent of retail price; sales of materials used in processing or manufacturing.

[7] City taxes, like the State sales tax, are retailers' occupation taxes based on gross receipts and are collected by the State.

[8] Services taxed include: hotels, laundry and dry cleaning, automobile and cold storage; printing and repair services to tangible personal property.

[9] Major exemptions are: sales of farm products by producer, fertilizer, containers for farm products, trade-ins, newspapers, ship chandlers' supplies, sales to Federal Government, and sales of gasoline and public utility services, which are otherwise taxed.

[10] The city taxes apply to all sales of property and services (except contracting) which are subject to the State sales tax. The State collects the city tax.

[11] The rate on industrial gas and electricity is ¼ percent.

[12] Services taxed include: hotels, laundry and dry cleaning, transfer and storage, cotton gins and warehouses, billiard parlors and bowling alleys, public utility services (except water and sewage), and miscellaneous repair services.

[13] Major exemptions are: sales of cotton, fertilizer, seed, containers for farm products, farm products and livestock sold by producer, sales to hospitals and public schools, and sales by agricultural or cooperative associations.

[14] The tax is patterned after the State gross receipts tax but applies only to retail businesses and services. The State collects the city tax.

[15] Motor vehicles and trailers are taxed at ½ percent.

[16] Major exemptions are sales of all farm products, materials and implements used in farming, insurance premiums, hospital receipts, sales of securities, newspapers and magazines, and water.

[17] Meals costing $1 or more (including cover charges) are taxable in New York City.

Compiled by Treasury Department, analysis staff, Tax Division.

TABLE 54.—*State excise taxes on distilled spirits,*[1] *Oct. 1, 1955*

[Per gallon]

50 cents to $1:
- Missouri
- Nevada
- South Dakota [2]
- Total, 3.

$1 to $1.50:
- Arizona
- Connecticut
- Delaware
- Georgia [3]
- Illinois
- Kansas
- Kentucky
- Nebraska
- New Mexico
- Texas
- District of Columbia
- Total, 11.

$1.50 to $2:
- California
- Colorado
- Louisiana
- Maryland
- New Jersey
- New York
- Rhode Island
- Total, 7.

$2 to $3:
- Arkansas [4]
- Florida [5]
- Indiana
- Massachusetts [6]
- Minnesota
- North Dakota [7]
- South Carolina
- Tennessee
- Wisconsin
- Total, 9.

1 Mississippi and Oklahoma prohibit the sale of liquors of alcoholic content of more than 4 percent and 3.2 percent, respectively. 16 States have liquor monopoly systems (Alabama, Idaho, Iowa, Maine, Michigan, Montana, New Hampshire, Ohio, Oregon, Pennsylvania, Utah, Vermont, Virginia, Washington, West Virginia, and Wyoming). Some of the monopoly States impose taxes generally expressed in terms of a percentage of retail price. Vermont, however, imposes a tax of $3.60 per gallon and thus falls in the group of States with highest taxes. North Carolina has county-operated stores in counties which vote in favor of their operation and the State imposes a tax of 10 percent of retail price.

2 In addition, a temporary tax of 3 percent of gross receipts from retail sales of alcoholic beverages is imposed.

3 The tax on distilled spirits manufactured within the State is 50 cents per gallon.

4 In addition, an excise tax of 3 percent is levied upon all retail receipts from sale of liquors, cordials, liqueurs, and specialties.

5 Includes the tax of $1.20, plus two additional taxes of 72 cents and 25 cents. The tax on beverages containing more than 48 percent alcohol by weight is $4.34, including the tax of $2.40 plus 2 additional taxes of $1.44 and 50 cents.

6 Includes permanent tax of $1.50, plus an additional tax of 50 cents and a temporary additional tax of 25 cents through June 30, 1957. An additional tax of ¼ percent of gross receits is imposed.

7 Includes permanent tax of 60 cents, plus an additional tax of 80 cents, effective until July 1, 1961, plus the wholesale liquor transactions tax of $1.10.

Source: Compiled by Treasury Department, analysis staff, Tax Division. From Commerce Clearing House, State Tax Reporter.

TABLE 55.—*State cigarette excise taxes, Nov. 15, 1955*

[Per standard package of 20 cigarettes]

2 cents:
- Arizona
- Missouri [1]
- Ohio [2]
- Wyoming
- District of Columbia
- Total, 5.

3 cents:
- Connecticut
- Delaware
- Illinois
- Indiana
- Iowa
- Kansas
- Kentucky
- Michigan
- Nebraska
- Nevada
- New Hampshire [3]
- New Jersey
- New York
- Oregon [4]
- Rhode Island
- South Carolina
- South Dakota (3.25 cents) [5]
- Total, 17.

4 cents:
- Alabama
- Idaho
- Minnesota
- Montana
- Utah
- Vermont
- West Virginia
- Wisconsin
- Total, 8.

5 cents:
- Florida
- Georgia
- Maine
- Massachusetts
- Mississippi
- New Mexico
- Oklahoma
- Pennsylvania
- Tennessee
- Texas
- Washington [6]
- Total, 11.

6 cents:
- Arkansas
- North Dakota
- Total, 2.

8 cents: Louisiana
- Total, 1.

[1] Scheduled to become effective Jan. 1, 1956. The constitutionality of the tax has been questioned.
[2] Includes the 1 cent per package increase which was approved by the voters in November 1955 but requires implementing legislation to be enacted at a special session in January 1956.
[3] The statutory rate is 15 percent of the retail price.
[4] Inoperative, pending referendum in November 1956.
[5] In addition, a temporary tax of 3 percent of gross receipts from sales of cigarettes, papers, wrappers, and tubes is imposed.
[6] The statutory rate is 2.5 cents for each 10 cents or fraction of the retail price.

Compiled by Treasury Department, analysis staff, Tax Division.

TABLE 56.—*State motor fuel tax rates,*[1] *Oct. 1, 1955*

[Per gallon]

3 cents:
- Missouri

4 cents:
- Indiana
- New Jersey
- New York [1]
- Rhode Island
- Total, 4.

5 cents:
- Arizona
- Delaware
- Illinois
- Kansas
- Massachusetts
- Minnesota
- New Hampshire [2]
- Ohio
- South Dakota
- Texas [1]
- Utah
- Wyoming [1]
- Total 12.

5½ cents:
- Vermont

6 cents:
- California [1 2]
- Colorado
- Connecticut [2]
- Idaho
- Iowa [1 2]
- Maryland

6 cents—Continued
- Michigan
- Nebraska [2]
- Nevada
- New Mexico
- North Dakota
- Oregon
- Pennsylvania [2]
- Virginia
- West Virginia
- Wisconsin
- District of Columbia
- Total, 17.

6½ cents:
- Arkansas
- Georgia
- Oklahoma (6.58)
- Washington
- Total, 4.

7 cents:
- Alabama
- Florida
- Kentucky
- Louisiana
- Maine
- Mississippi [1]
- Montana [1 2]
- North Carolina
- South Carolina [2]
- Tennessee (7.6)
- Total, 10.

[1] In most States, diesel fuel and other petroleum products are taxed at the same rate as gasoline. The States which tax diesel fuel at a different rate are as follows: California, 7 cents (until Dec. 31, 1959; 6½ cents thereafter); Iowa, 7 cents; Mississippi, 8 cents; Montana, 9 cents; New York, 6 cents; Texas 6.5 cents; Wyoming, 4 cents. Vermont does not tax diesel fuel.

[2] The rates shown include temporary rates scheduled to expire as follows: California, ½ cent, Dec. 31, 1959; Connecticut, 2 cents, June 30, 1957; Iowa (gasoline), 2 cents, June 30, 1957; Montana (gasoline), 1 cent, Mar. 31, 1957; Nebraska, 1 cent, May 9, 1959; New Hampshire, 1 cent, July 1, 1966; Pennsylvania, 3 cents, May 31, 1957; South Carolina, 1 cent, June 30, 1958.

Source: Treasury Department, analysis staff, Tax Division, Overlapping Taxes in the United States, p. 70.

ESTATE AND GIFT TAXES

TABLE 57.—*Federal estate- and gift-tax rate schedules under present law* [1]

Taxable net estate or net gift [2]		Estate-tax rates	Gift-tax rates
Exceeding	Equaling		
		Percent	*Percent*
0	$5,000	3	2.25
$5,000	$10,000	7	5.25
$10,000	$20,000	11	8.25
$20,000	$30,000	14	10.50
$30,000	$40,000	18	13.50
$40,000	$50,000	22	16.50
$50,000	$60,000	25	18.75
$60,000	$100,000	28	21.00
$100,000	$250,000	30	22.50
$250,000	$500,000	32	24.00
$500,000	$750,000	35	26.25
$750,000	$1,000,000	37	27.75
$1,000,000	$1,250,000	39	29.25
$1,250,000	$1,500,000	42	31.50
$1,500,000	$2,000,000	45	33.75
$2,000,000	$2,500,000	49	36.75
$2,500,000	$3,000,000	53	39.75
$3,000,000	$3,500,000	56	42.00
$3,500,000	$4,000,000	59	44.25
$4,000,000	$5,000,000	63	47.25
$5,000,000	$6,000,000	67	50.25
$6,000,000	$7,000,000	70	52.50
$7,000,000	$8,000,000	73	54.75
$8,000,000	$10,000,000	76	57.00
$10,000,000	----------	77	57.75

[1] Rates imposed by the Revenue Act of 1941.
[2] Net estate after deducting $60,000 exemption; net gift after deducting exemption of $30,000 and $3,000 annual exclusion for each donee.

TABLE 58.—*Effective rates of Federal estate tax for single persons and married persons at selected net estate levels, under present law* [1]

Net estate before specific exemption of $60,000	Single person	Married person (assuming one-half of estate is left to spouse)	Net estate before specific exemption of $60,000	Single person	Married person (assuming one-half of estate is left to spouse)
	Percent	*Percent*		*Percent*	*Percent*
$60,000	----------	----------	$500,000	23.3	9.1
$70,000	0.7	----------	$750,000	25.6	10.7
$80,000	2.0	----------	$1,000,000	27.0	11.7
$100,000	4.8	----------	$1,500,000	29.2	12.8
$120,000	7.8	----------	$2,000,000	31.3	13.5
$150,000	11.7	0.7	$2,500,000	33.2	14.1
$200,000	15.8	2.4	$5,000,000	40.8	16.6
$250,000	18.1	4.3	$7,500,000	46.1	18.7
$300,000	19.7	5.8	$10,000,000	49.8	20.4
$400,000	21.9	7.9			

[1] Under provisions of the Revenue Act of 1948. Rates are after allowing for the maximum credit for State death taxes.

TABLE 59.—*Federal gift tax: Effective rate for single and married persons, at selected net gift levels*

Net gift before exemption and exclusion	Married person		Single person
	Gift to spouse	Gift to 2 children	Gift to 2 persons
	Percent	*Percent*	*Percent*
$30,000			
$40,000			0.2
$50,000			1.4
$75,000	0.1	0.1	4.6
$100,000	1.0	1.4	8.0
$150,000	2.6	4.6	12.5
$200,000	4.3	8.0	15.0
$250,000	5.5	10.6	16.5
$400,000	7.7	15.0	19.2
$500,000	8.4	16.5	20.1
$1,000,000	10.1	20.1	23.4
$1,500,000	11.1	22.1	25.7
$2,000,000	11.8	23.4	27.6
$2,500,000	12.3	24.5	29.4
$4,000,000	13.8	27.6	34.1
$5,000,000	14.7	29.4	36.7
$10,000,000	18.4	36.7	45.5

TABLE 60.—*Estate and gift tax rates, 1916–54*

Date of death	Tax rates		Bracket subject to—	
	Estates	Gifts	Minimum rate	Maximum rate
	Percent	*Percent*		
Sept. 9, 1916, to Mar. 2, 1917	1–10		0–$50,000	$5,000,000 and over.
Mar. 3 to Oct. 3, 1917	1.5–15		0–50,000	Do.
Oct. 4, 1917, to Feb. 24, 1919	2–25		0–50,000	$10,000,000 and over.
Feb. 24, 1919, to Feb. 26, 1926	1–25	[1] 1–25	0–50,000	Do.
Feb. 26, 1926, to June 6, 1932	1–20		0–50,000	Do.
June 6, 1932, to May 10, 1934	1–45	.75–33.5	0–10,000	Do.
May 11, 1934, to July 30, 1935	1–60	.75–45	0–10,000	Do.
July 30, 1935, to June 25, 1940	2–70	1.55–52.5	0–10,000	$50,000,000 and over.
June 25, 1940, to Sept. 20, 1941	[2] 2.2–77	[2] 1.65–57.75	0–10,000	Do.
Sept. 20, 1941, to date	3–77	2.25–57.75	0–5,000	$10,000,000 and over.

[1] In effect June 2, 1924, to Dec. 31, 1925.
[2] Includes defense tax equal to 10 percent of tax liability.

TABLE 61.—*Estate and gift taxes: Specific exemptions and exclusions, revenue acts, 1916–42*

Revenue act	Estate tax		Gift tax	
	Specific exemption [1]	Insurance exclusion	Specific exemption [2]	Annual exclusion per donee
1916	$50,000		(3)	(3)
1918	50,000	$40,000	(3)	(3)
1924	50,000	40,000	$50,000	$500
1926	100,000	40,000	(4)	(4)
1932	50,000	40,000	50,000	5,000
1935	40,000	40,000	40,000	5,000
1938	40,000	40,000	40,000	4,000
1942	60,000		30,000	3,000

[1] Specific exemption granted to estates of nonresident citizens dying after May 11, 1934, on the same basis as resident decedents. No exemption granted to estates of resident aliens until Oct. 21, 1942, when a $2,000 exemption was made available.
[2] Under the 1924 act, exemption allowed each calendar year. Under the 1932 and later acts, specific exemption allowed only once.
[3] No gift tax.
[4] Repealed.

TABLE 62.—*Number of taxable estate tax returns filed as percent of total number of adult deaths, 1939–51*

Year	Adult deaths in the United States [1]	Taxable estate tax returns filed	
		Number	Percent of adult deaths [2]
1939	1, 204, 080	12, 720	1. 06
1940	1, 235, 484	12, 907	1. 04
1941	1, 215, 627	13, 336	1. 10
1942	1, 209, 661	13, 493	1. 12
1943	1, 275, 400	12, 726	1. 00
1944	1, 237, 508	12, 154	. 98
1945	1, 238, 360	13, 869	1. 12
1946	1, 230, 754	(3)	(3)
1947	1, 277, 852	18, 232	1. 43
1948	1, 284, 535	19, 742	1. 54
1949	1, 284, 196	17, 469	1. 36
1950	1, 303, 071	17, 411	1. 34
1951	1, 328, 809	18, 941	1. 43

[1] Age 20 and over: Data from U. S. Public Health Service.
[2] Actual ratio of estate tax returns to adult deaths may differ somewhat from these percentages because the filing of estate tax returns may lag as much as 15 months behind date of death.
[3] Estate tax returns filed in 1946 were not tabulated.

Source: Internal Revenue Service, Statistics of Income, pt. 1.

TABLE 63.—*Estate tax returns: Number, gross estate, net estate, and tax, 1916–51*

[Dollar amounts in millions]

Year	Number of returns	Gross estate	Net estate	Tax
Sept. 9, 1916–Jan. 15, 1922	45, 126	$8, 893	$5, 510	$357
Jan. 15–Dec. 31, 1922	13, 876	3, 014	1, 705	121
1923	15, 119	2, 804	1, 532	89
1924	14, 513	2, 567	1, 396	72
1925	16, 019	3, 002	1, 659	87
1926	14, 567	3, 408	1, 973	102
1927	10, 700	3, 173	1, 762	42
1928	10, 236	3, 554	1, 993	42
1929	10, 343	3, 893	2, 314	44
1930	10, 382	4, 166	2, 427	42
1931	9, 889	4, 076	2, 356	45
1932	8, 507	2, 830	1, 423	24
1933	10, 275	2, 061	1, 001	61
1934	11, 853	2, 267	1, 171	96
1935	12, 724	2, 460	1, 340	155
1936	13, 321	2, 312	1, 260	196
1937	17, 032	2, 794	1, 647	308
1938	17, 642	3, 070	1, 745	317
1939	16, 926	2, 768	1, 558	279
1940	16, 876	2, 648	1, 493	252
1941	17, 122	2, 793	1, 576	293
1942	17, 396	2, 737	1, 536	310
1943	16, 033	2, 638	1, 405	363
1944	14, 857	2, 916	1, 516	406
1945	16, 550	3, 450	1, 911	533
1946	(1)	(1)	(1)	(1)
1947	22, 007	4, 251	2, 341	626
1948	24, 381	4, 791	2, 597	717
1949	25, 904	4, 958	2, 126	571
1950	27, 144	4, 942	1, 935	487
1951	29, 022	5, 527	2, 205	580

[1] Not available.

ource Internal Revenue Service, Statistics of Income, pt. 1.

TABLE 64.—*Taxable estate tax returns filed in 1951* [1]*: Number of returns, net estate and tax liability, by gross estate classes*

[Gross estate classes and money figures in thousands of dollars]

Gross estate classes	Number of returns	Net estate before exemption	Tax liability
$60 to $70	1,041	$65,651	$106
$70 to $80	1,817	125,759	916
$80 to $90	1,507	116,093	1,998
$90 to $100	1,243	104,725	2,862
$100 to $120	2,038	189,912	7,948
$120 to $150	2,664	263,729	15,450
$150 to $200	2,828	335,963	29,525
$200 to $300	2,482	407,027	54,267
$300 to $500	1,675	431,252	79,554
$500 to $1,000	995	467,634	107,685
$1,000 or more	503	803,390	276,268
Total	18,793	3,311,137	576,579
	Percentage distribution		
$60 to $70	5.5	2.0	(2)
$70 to $80	9.7	3.8	0.2
$80 to $90	8.0	3.5	.3
$90 to $100	6.6	3.2	.5
$100 to $120	10.9	5.7	1.4
$120 to $150	14.2	8.0	2.7
$150 to $200	15.0	10.1	5.1
$200 to $300	13.2	12.3	9.4
$300 to $500	8.9	13.0	13.8
$500 to $1,000	5.3	14.1	18.7
$1,000 or more	2.7	24.3	47.9
Total	100.0	100.0	100.0

[1] For decedents who died after Dec. 31, 1947.
[2] Less than one-half of 1 percent.

Source: Internal Revenue Service, Statistics of Income for 1950, pt. 1.

TABLE 65.—*Selected items on estate tax returns, 1951* [1]

[Dollar amounts in thousands]

Gross estate classes [2]	Gross estate	Marital deductions	Charitable public and similar bequests	Net deduction for property previously taxed	Specific exemption	Total allowable deductions	Net estate for additional tax: Amount	Net estate for additional tax: Percent of gross estate
Taxable returns:								
$60,000, under $70,000	$69,444	$31	$52	$38	$62,460	$66,252	$3,191	4.6
$70,000, under $80,000	136,180	656	283	154	109,020	119,441	16,739	12.3
$80,000, under $90,000	127,918	1,107	564	548	90,420	102,245	25,673	20.1
$90,000, under $100,000	117,829	2,795	540	449	74,580	87,684	30,145	25.6
$100,000, under $120,000	222,475	10,087	1,568	1,569	122,280	154,842	67,632	30.4
$120,000, under $150,000	359,531	61,517	1,939	2,843	159,840	255,642	103,889	28.9
$150,000, under $200,000	488,249	100,476	4,131	4,400	169,680	321,965	166,283	34.1
$200,000, under $300,000	600,117	117,976	9,704	6,070	148,920	342,010	258,107	43.0
$300,000, under $500,000	637,210	114,609	16,723	7,275	100,500	306,458	330,752	51.9
$500,000, under $1,000,000	674,531	107,956	25,281	6,100	59,700	266,596	407,934	60.5
$1,000,000, under $2,000,000	476,506	70,956	30,537	2,314	20,880	169,458	307,047	64.4
$2,000,000, under $3,000,000	198,049	31,140	17,153	186	4,860	70,844	127,205	64.2
$3,000,000, under $5,000,000	113,162	9,746	13,775	1,299	1,740	35,295	77,867	68.8
$5,000,000, under $10,000,000	235,850	13,186	52,264	40	2,040	85,775	150,075	63.6
$10,000,000 or more	182,616	22,937	31,704		660	71,599	111,016	60.8
Total, taxable returns	4,639,665	665,174	206,218	33,286	1,127,580	2,456,108	2,183,557	47.1
Nontaxable returns:								
Under $60,000	625	53			660	858		
$60,000, under $70,000	156,149	28,740	2,985	263	145,380	194,705		
$70,000, under $80,000	121,800	39,960	3,577	486	97,680	156,758		
$80,000, under $90,000	112,646	42,670	2,783	800	79,680	138,254		
$90,000, under $100,000	100,264	39,651	3,304	581	63,480	118,172		
$100,000, under $120,000	158,627	64,715	4,239	1,357	86,820	175,601		
$120,000, under $150,000	90,360	31,991	6,468	690	41,940	97,815		
$150,000, under $200,000	34,037	6,728	6,861	507	12,060	38,022		
$200,000, under $300,000	21,860	2,045	8,669	572	5,520	24,958		
$300,000, under $500,000	15,454	421	7,825	438	2,460	24,520		
$500,000, under $1,000,000	15,225	911	10,541	460	1,320	16,009		
$1,000,000, under $2,000,000	11,305	151	5,650		420	15,078		
$2,000,000, under $3,000,000	2,215		2,096		60	2,264		
$3,000,000, under $5,000,000	3,505		3,131		60	3,533		
Total nontaxable returns	844,074	258,036	68,130	6,154	537,540	1,006,545		
Grand total	5,483,739	923,210	274,348	39,440	1,665,120	3,462,653	2,183,557	39.8

[1] Returns filed for estates of citizens and resident aliens who died on or after Jan. 1, 1948.

[2] Gross estate classes are based on the total gross estate, either date of death value or optional value, as elected by the executor for tax purposes.

Source: Statistics of Income for 1950, pt. 1.

TABLE 66.—*Number of taxable estate tax returns filed in 1951; by size of net estate: Percentage distribution by types of heirs*

[Percent]

Net estate before specific exemption	Total	Spouses only	Children only	Spouses and children only	Spouses and others (not children)	Children and others (not spouses)	Spouses, children, and others	Other combinations
$60,000 to $80,000	100.0	6.1	22.7	28.1	4.2	10.4	5.9	22.6
$80,000 to $100,000	100.0	5.6	23.5	24.6	5.2	10.9	6.8	23.4
$100,000 to $150,000	100.0	4.5	21.8	24.8	5.2	12.8	8.2	22.7
$150,000 to $200,000	100.0	3.3	18.4	24.5	5.9	16.5	9.0	22.4
$200,000 to $300,000	100.0	3.2	17.2	23.2	5.8	15.9	10.5	24.2
$300,000 to $400,000	100.0	2.9	17.8	20.8	6.8	18.6	11.5	21.6
$400,000 to $500,000	100.0	2.8	15.4	19.9	7.8	19.3	10.7	24.1
$500,000 to $600,000	100.0	1.8	13.5	18.3	6.6	23.1	13.1	23.6
$600,000 to $700,000	100.0	2.7	10.0	21.3	4.7	22.7	13.3	25.3
$700,000 to $800,000	100.0	2.2	6.5	19.6	6.5	20.7	14.1	30.4
$800,000 to $900,000	100.0	4.7	9.4	12.5	12.5	21.9	10.9	28.1
$900,000 to $1,000,000	100.0	----------	11.1	24.1	5.5	18.5	16.7	24.1
$1,000,000 or more	100.0	0.7	15.0	19.4	6.8	20.7	15.0	22.4
Total	100.0	4.8	21.1	25.2	5.2	12.9	7.8	23.0

Source: Internal Revenue Service, Statistics of Income for 1950, pt. 1.

TABLE 67.—*Federal estate tax liability before State death tax credit, and State death tax credit, for returns filed during 1929–51*

[Dollar amounts in millions]

Year	Federal estate tax liability before State death tax credit	State death tax credit	
		Amount	Percent of Federal tax before credit
1929	$165.4	$122.1	73.8
1930	152.4	113.4	74.4
1931	182.2	137.7	75.6
1932	84.0	61.6	73.4
1933	76.7	20.1	26.2
1934	129.2	33.9	26.3
1935	197.7	43.9	22.2
1936	239.6	44.2	18.5
1937	364.2	58.3	16.0
1938	374.6	59.8	16.0
1939	330.2	53.1	16.1
1940	295.7	45.3	15.3
1941	336.5	53.6	15.9
1942	330.7	45.6	13.8
1943	398.2	36.0	9.0
1944	452.2	46.3	10.2
1945	596.1	64.5	10.8
1946	(1)	(1)	(1)
1947	693.6	69.9	10.1
1948	799.3	82.7	10.3
1949	634.9	65.8	10.4
1950	533.9	48.9	9.2
1951	644.4	64.5	10.0

[1] Not available.

Source: Internal Revenue Service, Statistics of Income, pt. 1.

TABLE 68.—*Number of gift tax returns, total gifts before exclusion, net gifts, and gift tax, 1933–51*

[Dollar amounts in thousands]

Year	Number of returns		Total gifts before exclusion [1]	Net gifts	Gift tax
	Total	Taxable			
1933	3,683	878	$241,008	$101,793	$8,943
1934	9,270	2,528	888,753	537,083	68,383
1935	22,563	8,718	2,130,514	1,196,001	162,798
1936	13,420	3,770	482,783	134,979	15,664
1937	13,695	4,128	568,109	180,939	22,758
1938	11,042	3,515	399,773	138,801	17,839
1939	12,226	3,929	371,604	131,577	18,701
1940	15,623	4,930	570,042	225,972	34,445
1941	25,788	8,940	1,081,482	484,319	69,819
1942	16,906	4,380	480,223	120,653	24,665
1943	16,987	4,656	412,655	122,936	29,637
1944	18,397	4,979	499,012	148,420	37,781
1945	20,095	5,540	535,559	169,625	36,633
1946	24,826	6,808	755,604	265,246	62,336
1947	24,857	6,822	777,613	256,534	64,402
1948	26,200	6,559	740,923	209,148	45,338
1949	31,547	6,114	708,381	178,035	36,087
1950	39,056	8,366	1,064,200	337,719	77,605
1951	41,703	8,360	999,518	304,131	67,426

[1] Includes gifts made on nontaxable returns.

Source: Internal Revenue Service, Statistics of Income, pt. 1.

Total gift plus gift tax classes [1]	Number of returns	Total gifts before exclusions [2]	Exclusions		Deductions				Net gifts		Gift tax			
											1950		Aggregate	
			Amount	Percent of total gifts before exclusions	Charitable public, and similar gifts after exclusions	Marital deductions	Specific exemption 1950	Total deductions	1950	Aggregate	Amount	Percent of total gifts before exclusions	Amount	Percent of total gifts before exclusions
Taxable returns:														
Under $3,000	110	$144	$8	5.6	--------	--------	$10	$10	$126	$5,640	$13	9.0	$908	630.6
$3,000, under $10,000	1,205	7,610	4,582	60.2	$17	$234	177	428	2,599	77,907	272	3.6	14,369	188.8
$10,000, under $20,000	1,391	19,238	9,085	47.2	241	743	1,596	2,580	7,573	90,492	820	4.3	17,179	89.3
$20,000, under $30,000	934	21,766	7,608	35.0	455	665	3,242	4,362	9,797	63,683	1,097	5.0	12,467	57.3
$30,000, under $40,000	1,023	34,652	6,828	19.7	643	658	15,575	16,877	10,948	50,17	1,240	3.6	9,074	26.2
$40,000, under $50,000	924	39,752	7,847	19.7	602	538	17,738	18,879	13,027	50,954	1,408	3.5	9,821	24.7
$50,000, under $100,000	1,624	102,191	15,971	15.6	2,942	4,120	28,788	35,850	50,370	160,652	6,590	6.4	33,794	33.1
$100,000, under $400,000	954	149,594	11,373	7.6	10,796	4,742	10,963	26,501	111,721	360,839	23,169	15.5	97,419	65.1
$400,000, under $800,000	120	53,869	2,068	3.8	8,005	1,344	1,060	10,409	41,393	115,638	10,278	19.1	35,338	65.6
$800,000, under $1,000,000	22	16,075	228	1.4	1,918	1,105	116	3,139	12,708	25,231	3,347	20.8	6,599	41.1
$1,000,000, under $2,500,000	43	52,722	1,033	2.0	8,508	269	150	8,927	42,760	95,249	13,481	25.6	29,822	56.6
$2,500,000, under $5,000,000	12	34,927	620	1.8	19,689	602	55	20,347	13,961	62,817	6,070	17.4	27,003	77.3
$5,000,000, under $10,000,000	2	10,243	54	.5	1,880	--------	--------	1,880	8,309	17,837	3,818	37.3	7,991	78.0
$10,000,000 or more	2	35,648	177	.5	23,044	--------	--------	23,044	12,427	189,234	6,001	16.8	106,885	299.8
Total taxable returns	8,366	578,431	67,481	11.7	78,741	15,020	79,469	173,231	337,719	1,366,352	77,605	13.4	408,667	70.7
Nontaxable returns:														
Under $3,000	2,001	4,334	3,784	87.3	12	3	535	550	--------	10,889	--------	--------	2,168	50.0
$3,000, under $10,000	12,043	73,941	51,953	70.3	1,103	3,153	17,732	21,989	--------	88,599	--------	--------	16,850	22.8
$10,000, under $20,000	8,565	119,250	53,122	44.5	3,314	5,448	57,366	66,128	--------	85,438	--------	--------	17,844	15.0
$20,000, under $30,000	4,175	101,413	29,191	28.8	3,132	5,014	64,076	72,222	--------	43,614	--------	--------	9,763	9.6
$30,000, under $40,000	2,834	94,816	22,590	23.8	2,938	4,556	64,731	72,226	--------	28,011	--------	--------	7,129	7.5
$40,000, under $50,000	552	24,157	7,689	31.8	2,443	2,822	11,203	16,468	--------	33,440	--------	--------	12,836	53.1
$50,000, under $100,000	407	25,199	5,515	21.9	7,928	5,188	6,568	19,684	--------	51,556	--------	--------	13,351	53.0
$100,000, under $400,000	89	15,335	1,464	9.5	13,618	89	164	13,871	--------	58,473	--------	--------	18,504	120.7
$400,000, under $800,000	14	7,231	194	2.7	7,022	--------	16	7,038	--------	2,682	--------	--------	718	9.9
$800,000, under $1,000,000	3	2,627	18	.7	2,609	--------	--------	2,609	--------	7,038	--------	--------	2,893	110.1
$1,000,000, under $2,500,000	5	6,628	12	.2	6,616	--------	--------	6,616	--------	929	--------	--------	205	3.1
$2,500,000, under $5,000,000	1	4,938	3	.1	4,935	--------	--------	4,935	--------	154	--------	--------	28	.6
$5,000,000 or more	1	5,901	18	.3	5,883	--------	--------	5,883	--------	5,284	--------	--------	1,994	33.8
Total nontaxable returns	30,690	485,769	175,552	36.1	61,552	26,273	222,392	310,217	--------	416,109	--------	--------	104,282	21.5
Grand total	39,056	1,064,200	243,033	22.8	140,293	41,294	301,861	483,448	337,719	1,782,461	77,605	7.3	512,949	48.2

[1] Total gift plus gift tax classes are based on the sum of the current year total gifts before exclusions and the current year gift tax. Nontaxable returns have no gift tax, but are distributed under this classification on the bases of total gifts before exclusion.

[2] After allowing for gifts of taxpayers reported by spouse and gifts of spouse reported by taxpayer.

NOTE.—Detail may not add to totals because of rounding.

Source: Internal Revenue Service, Statistics of Income, pt. 1.