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THE 1943 REVENUE BILL

RANDOLPH E. PAUL*

I am more than glad to be in Indianapolis tonight. Apart from the honor conferred in an invitation from the Indiana State Bar Association, the capital of this State brings special recollections to me. It was the scene of early labors on tax books published by the Bobbs-Merrill Company. Those were the happy days when two years elapsed between revenue acts, and tax law did not change before printer's ink was dry. We worked day and night here in the Claypool Hotel feeding manuscript to our insatiable publisher. Little did I think then that I should return to Indianapolis many years later to close the circle by appearing before this gathering as a specialist in tax matters.

I should like to talk to you tonight not just as a specialist, but also as a fellow-citizen. Specialists have a way of speaking evasively in \$2 words and in long dreary paragraphs. The charge has been made, sometimes with justification, that they have a vested interest in keeping their subject mysterious so that their special skill will not lose its market value. I want to talk frankly and directly in 10-cent words. You Hoosiers have a reputation for being able to take straight talk. I am counting on you to live up to that reputation tonight.

To begin with, I want to say unequivocally that the Revenue Bill of 1943, as it is about to be debated on the Senate floor, is a tragic failure. It fails to meet the three principal

* General Counsel, U.S. Treasury Department, Washington, D.C.

tests of a wartime revenue measure. First, it does not raise enough revenue. Second, it fails as an instrument to reduce inflationary pressure. Third, it denies to more than 50 million taxpayers the simplification of tax law to which they are entitled. And, finally, it makes renegotiation unworkable and ineffective as a means of controlling profits on war contracts.

THE REVENUE TEST

We may as well face the facts at the outset. With war expenditures of \$92 billion in the current (1944) fiscal year, a total reduced budget of \$98 billion, and a revenue yield from existing taxes of \$41 billion, we are running a deficit of \$57 billion. In November, 1943, the Federal Government spent \$5.7 billion more than it collected in revenue. We were accumulating debt at the rate of nearly \$200 million a day. At the end of the fiscal year, June 30, 1944, this means a debt of about \$200 billion, on which the interest charges will be close to \$4 billion a year.

There is no escape from these expenditures. They are war expenditures. They provide weapons for our fighting forces. If we could, we would spend more; if we had no increased revenue possibilities, we would still spend to win the war as completely and as quickly as possible.

But the very emergency which makes us spend provides the stuff of debt avoidance. In 1933 citizens had cash income after taxes of \$44 billion; in the glorious year 1929, they had \$80 billion. In the current fiscal year 1944 they will have \$126 billion, far above the prosperity we thought we had in the peak year of the Twenties. The way out of debt accumulation is plain to nearly every eye.

It was plain to the Treasury on October 4, 1943, when the Secretary of the Treasury proposed to the House Ways and Means Committee an additional tax program of \$10.5 billion which he described on November 29th as "needed to safeguard the financial and economic future of this country during and after the war."

This program might have been criticized as inadequate, but it could hardly be fairly condemned as too drastic. We faced a period in which consumer income after taxes, \$126 billion, exceeded by \$36 billion the amount required to buy the \$90 billion of available consumer goods and services at

present prices. Our people would have \$36 billion which would not be spent. The \$10.5 billion program would have appropriated to government use in wartime—in the most critical period in our history—less than one-third of the excess. It would have permitted us to save over 5 times as much as the \$5 billion we were able to save in liquid forms in 1940, the highest amount ever saved in any year in the pre-war decade.

Our people are financially prosperous. In the period from January 1, 1940, to June 30, 1943, they accumulated \$55 billion of savings, after paying increased taxes. In 1943 they spent nearly twice as much for clothing as in 1939. They spent more than twice as much on restaurant meals and drinks. They spent nearly three times as much on jewelry. I do not mean to imply that every American is living in a paradise of silk shirts, juicy steaks, and corona-coronas, though I cannot help recalling the aphorism of your distinguished neighbor who said: "What this country needs is a good five-cent cigar."

With all this spending the American people have saved more than ever before. They have accumulated in the last 3½ years liquid savings of more than \$55 billion of which fully half is in increased currency and bank accounts. Is it not clear that they could afford to pay \$10.5 billion of additional taxes? I, for one, believe they would have been willing, if not glad, to do so.

If I am right, little need be said about the bill soon to be debated in the Senate. As it passed the House, it was expected to raise \$2.1 billion in a full year of operation. The cancellation of the automatic rise in Social Security taxes will reduce prospective receipts by \$1.4 billion. That means that the Senate bill will raise only \$876 million. This is without allowance, however, for revenue losses and increases in expenditures resulting from the Finance Committee renegotiation amendments which open the door to war profiteering. If these amendments stand, it will be years before we know precise financial effects; but it is possible that they will put the bill in the red. In short, what started out to be a revenue bill is now in large part a measure to appropriate public funds for "relief" of war profiteers and others.

I wonder what returning soldiers and sailors and marines will think of this tax measure—a statute passed by the people

at home which says: We did not want to surrender to the Government a third of our war-made prosperity while you were fighting the enemy in mountain, jungle, desert and on the sea. We preferred to pass on the load to the future when you who fought would also be required to pay.

INFLATION TEST

One might understand a refusal to be taxed, if it meant more purchasing power in the pockets and bank accounts of taxpayers. Against the big loss of participation in the war effort there would be the small, immediate gain of increased wealth. From a narrow, selfish viewpoint such an attitude might make sense. But the grim fact is that as a people we gain nothing by refusing to pay taxes. On the contrary, we stand to lose a great deal. Inflation very well may take what we do not pay to the tax collector. And more.

I some times suspect that many of us are passive about inflation because we have heard so much about it. For two years the economists have been warning us that inflation would soon engulf us, yet so far we are only knee-deep in it. We forgot that it has stayed within bounds because of the steps we have taken to prevent rising prices. The danger is that we are emotionally weary of hearing the word "inflation" at the very time it is most threatening. You remember the fable of the shepherd boy who assuaged his loneliness by crying, "Wolf, Wolf," to the villagers. When the wolf actually came, he lost his flock because the people refused to believe him.

I cannot cover the subject of inflation in a short evening address. It comes from a sudden and enormous increase of money among a people without a corresponding increase of things to buy. It ends in prices that take away the buying power of savings as well as income. You may have seen the picture of "Joe's Diner" in Harry Scherman's pamphlet on inflation. A returning soldier is sitting on a stool in front of the counter with his hand reaching into his pocket for money. His uplifted face is directed at a sign to which the waiter is pointing. The sign lists prices: coffee, 50 cents; coffee, with cream, 75 cents; hamburger, \$1; hamburger, with french fried potatoes, \$1.50. The title of the picture is a question: "Shall we let him come home to this?"

He may very well come home to such prices—and we at home may pay such prices—unless we face the economic facts that meet every qualified eye. Without reduction, pressure of abundant income will be too much for our existing price structure. Price and wage ceilings, and rationing have held the line fairly well so far. No one knows the ultimate breaking point of these direct control devices, but we do know that they are now threatened. More than ever they need the help of additional taxes which reduce spending power. If they do not get this help, and other help that is being asked, our soldiers and sailors and marines may return to 50 cent coffee and \$1 hamburgers.

The arithmetic of inflation is simple. In 1939 consumers had \$11 to spend upon every \$10 of goods. In 1940 they had \$11.10; in 1941, \$11.80; in 1942, \$13.30; in the first half of 1943, \$13.80. The rate promises to be about \$14 for the fiscal year 1944 as compared with \$11 in 1939. In total terms the Nation has \$126 billion of spending power this fiscal year—after existing taxes—against \$90 billion of available goods. The excess of \$36 billion, plus accumulated savings of \$55 billion, make a total of over \$90 billion nervous dollars, which threaten our price structure with collapse.

Neither the House nor the Senate bill attempts to cope with this dangerous situation. Any pretense that the bill will appreciably diminish inflationary pressure is what Justices Holmes called "little more than a fiction intended to beautify what is disagreeable to the sufferers." A \$2 billion tax bill is hardly a gesture of inflation prevention. It indicates that the Congress either does not see the inflation clouds on the horizon, or that it does not choose to batten down the hatches against them.

SIMPLIFICATION TEST

Before examining the new tax bill in the light of its failure to meet the popular demand for simplification, I shall confess that I have made two speeches in favor of simplifying our tax laws. In this, my third attempt, I am reminded of Fit the First in Lewis Carroll's "The Hunting of the Snark"

" . . . Just the place for a Snark! I have said it twice:
That alone should encourage the crew.
Just the place for a Snark! I have said it thrice:
What I tell you three times is true."

I hope that what I shall say may be true of itself and not by virtue of reiteration. I hope it was true the first time I said it.

The desirability of simplifying our tax laws is so obvious that I shall not labor it here. One set of figures is enough. In 1932 exemptions and national income were at such levels that less than two million returns were filed with the Bureau of Internal Revenue. Time and the war will raise this figure to 44 million for 1944.

In this distinguished group of Indiana attorneys I should like to draw one item from my personal experience in the tax field. When I was in your position I was interested in the problems of the few clients I had. Their problems were in the field of estate and gift taxes, corporate reorganizations, valuation, trusts. I was intensely concerned with the complication of our tax laws in this territory. It seemed unjustifiable. I still believe it is intolerable, and I shall leave no stone unturned in my effort to make these provisions of the statute simpler and easier for the taxpayers who are most affected by them to understand. That is a long, uphill job if we would do it well. As Mr. Justice Jackson said in the recent Dobson case: "No other branch of the law touches human activities at so many points. It can never be made simple, but we can try to avoid making it needlessly complex."

But I must confess to a shift of interest since I have been with the Treasury Department. Our immediate problem today is simplification for the masses of taxpayers. If the income tax—the bulwark of our tax system—is to succeed, we must find a way of making the tax understandable to 50 million taxpayers who cannot employ lawyers and accountants. We must tackle the job in full realization that these millions are not concerned with what the statute and the regulations and the court decisions say. To them the income tax return and the instructions on that return are the whole story. It is logical, then, that simplification should begin at that level.

It was at that level that the Treasury began its current campaign against income tax complexity. A group of legal and research experts, joined by several specialists in the layman's point of view, gathered around the conference table last summer to simplify individual income tax returns. They introduced a number of new features into the returns to be filed next March, and made some progress in modifying the

traditional form of the income tax return in the interest of simplification.

I am frank to predict, however, that taxpayers will not call the results simple. Time and again the move for simplification has run against a stone wall. The primary obstructions this year were the Victory tax and the cancellation feature involved in the transition to a pay-as-you-go system. Fortunately, the hurdle of cancellation will be behind us when we draft the return forms for 1945.

In this group I need not elaborate upon the complications of the Victory tax. I need only remind you, first, that the Victory tax has introduced a separate concept of taxable income; second, that it uses an exemption different from the regular income tax exemption; third, that it requires an entirely separate tax computation; and fourth, that it recognizes family status only through a complicated credit. This credit was labeled a postwar credit, but was made available currently on such easy terms that the word "postwar" became a misnomer. Congress, recognizing this infirmity, eliminated the postwar aspects of the credit and made it simply a current credit. The Treasury recommended this change and would go even further. It would like to see the rest of this noble experiment given a decent burial. In contemplation of its death, the logical move would be to shift the burden of the Victory tax to the regular income tax structure. To that end the Treasury has proposed that the Victory tax be eliminated and that with a reduction of exemptions and dependency credits its burden be absorbed into the net income tax scale.

The tax bill, as passed by the House, would repeal the Victory tax, an essential step if we are to achieve simplification. However, instead of integrating it with the regular income tax, it sets up a separate minimum tax. In other words, it replaces an additional tax with an alternative tax. If this minimum tax were to become law, the taxpayer would be confronted with two alternative taxes, each with different rates and each with an entirely different set of exemptions. The relationships between the minimum tax and the regular tax are so complex and elusive that many husbands and wives would be forced to go through a lengthy series of alternative computations to determine their lowest possible tax liability. All in all, the Treasury concluded that the minimum

tax "cure" prescribed in the House bill is worse than the Victory tax "disease."

Fortunately, the defects of the minimum tax plan in the House bill were so patent that the Senate Finance Committee refused to accept it. Unfortunately, the Committee was unwilling to abandon the Victory tax, although it did effect some simplification by changing its rate to a flat 3 percent for every taxpayer regardless of marital or dependency status.

You may wonder why the House, with its minimum tax, and the Senate Finance Committee, with its modified Victory tax, are straining every legislative muscle to keep a separate income tax in existence. The crux of the matter is the 9 million taxpayers at the bottom of the tax scale who are now paying the Victory tax, but would be relieved from any tax on income under the Treasury proposal. To clear away the smoke screen with which this issue has been confused, I should like to explain briefly why the Treasury felt it desirable to relieve these taxpayers from Federal taxes on income.

The absorption of the Victory tax would not result in a reduction of the total tax burden of the 9 million taxpayers. As a consequence of the excise tax increases proposed by the Treasury, they would pay practically as much under the Treasury proposals as under present law.

It is important to identify the 9 million taxpayers who would be relieved of future Federal taxes on income. They are exclusively heads of families earning less than the exemptions proposed by the Treasury, that is, \$1,100 per year plus \$300 for each dependent. The only reason why they are now taxable is that their income exceeds the flat \$624 Victory tax exemption which applies to every income recipient regardless of his family obligations.

If the 9 million taxpayers who are the center of the controversy could be kept on the rolls without undue complexity and if the proportion of their contributions to total revenue were substantial, some justification could be found for their retention as income-tax payers. But these conditions simply cannot be met. To extend the regular income tax downward to encompass these 9 million taxpayers would subject them to crushing and inequitable burdens. The alternative, represented by the Victory tax and substitutes devised by the Congressional tax committees, imposes distressing complexities on 50 million taxpayers without contributing

substantially to income tax revenues. Even the pretty label "Victory tax" cannot conceal the unfortunate complexity of a dual income tax system. The label on the cover cannot change the nature of the contents—it is a Pandora's box of troubles no matter what we call it.

Although the Treasury's proposals as a whole would not sacrifice revenue from the 9 million taxpayers, there would be a loss in income tax revenue from this group. At present, the 9 million taxpayers in question are paying about \$275 million in Victory taxes. Under the House bill, they would pay \$161 million and under the Senate Finance Committee version of the bill, they would pay slightly more than \$275 million. In other words, to collect less, perhaps much less, than \$300 million from the 9 million taxpayers at the bottom of the income scale, the 1943 Revenue Bill would complicate the collection of \$17 billion from 50 million taxpayers throughout the scale. I repeat what I stated to the Senate Finance Committee several weeks ago in analyzing the House bill: "It seems utterly unreasonable to erect a mountain of complexity for such a molehill of revenue."

RENEGOTIATION

Believe it or not, I have yet to reach the worst feature of the 1943 Revenue Bill. I have protested that the bill does not raise sufficient revenue. I have declared that it almost completely ignores the threat of inflation. I have said that it refuses to millions of taxpayers the basic simplification that they deserve. These are tax criticisms of the bill: they are deficiencies rather than positive faults. My fourth count against the bill, particularly the Senate Finance Committee version, is that it makes a dead letter of the provisions of the "renegotiation" statute designed to prevent exorbitant profits on war contracts.

When the Government began making contracts for war supplies in 1940, the big question was how to hold down profits. Everyone remembered the profiteering and inflation of the last war. Then we had relied on the excess profits tax to curb profits. We relied in vain. War business built many fortunes. For twenty years after the 1918 Armistice the country talked about taking the profit out of war. Perhaps some of you recall the Republican and Democratic party platform pledges of 1924. Both declared that in event of a war

in which citizens were drafted, all other resources should likewise be drafted. Yes, while public memory was still green, we were solidly against lush war profits.

The law on renegotiation of war contracts was passed in April, 1942. This new kind of war profit legislation was a response to the Government and business criticism of rigid profit limitations based on an allowable profit upon a low and arbitrary percentage of sales. The law was made flexible so that justice could be done in individual cases. Yet we hear much criticism now that the renegotiation statute has no standards. It can be made plain and rigid by recourse to the old arbitrary limitation expedient. But the chief sufferers would be the business men who complain of its vagueness.

The law directed the war procurement agencies, principally the War Department, Navy Department, and Maritime Commission, to require renegotiation of the contract price whenever a contract yielded excessive profits. It also directed them to eliminate inordinate profits by reductions in the contract price.

The assignment was known to be hard. In fact, the task of renegotiating with the tens of thousands of contractors and subcontractors engaged in war production was gargantuan. The departments organized for their work. They set up Price Adjustment Boards. They recruited personnel largely from business, law and accounting.

To date the total amount reclaimed from excessive prices on war contracts by renegotiation is well over \$5 billion. The \$5 billion does not represent net savings. Without renegotiation, the greater part of this figure would have been collected in excess profits taxes. Renegotiation, however, has saved at least \$1½ billion that would not have been touched by taxes. If the Price Adjustment Boards are not impeded in their work, they will probably save the Government as much again in the days to come.

I should like to tell you dramatically how the renegotiation provisions of the pending Revenue Act are but an invitation to repeat the mistakes of the First World War, are but a preface to bitter charges of war profiteering. But good drama, of necessity, distorts some of the facts. So I shall sacrifice histrionics on the altar of accuracy.

The bill contains a provision permitting contractors to

reopen in the courts all "closed" renegotiation cases, that is, cases which have resulted in voluntary agreement between the Government and the war contractor. There can be no valid objection to a procedure which protects contractors in their right to a fair determination of the facts and to adequate judicial review of decisions of administrative agencies. However, this principle can have no application to those cases in which agreements have been reached. Attempts to make it applicable to them fall wide of the mark. The adoption of this provision will mean that over 8,000 cases, involving over \$5 billion of refunds and price reductions, may be reopened and interminably litigated.

Another provision restricts the application of the Act by making it apply only to contracts or subcontracts for "components" of articles actually delivered to the Government under prime contracts. It exempts from renegotiation a large group of subcontractors who have admittedly made excessive profits. To make matters worse, it is made retroactive, requiring the Government to refund millions already recovered from these companies.

A mandatory exemption for "standard commercial articles" exempts the profits—however excessive they may be—from the sale of such articles from renegotiation. The record shows that exorbitant profits are being earned on a large scale by concerns that produce standard commercial articles. As a matter of fact, contractors making standard commercial articles hold a more advantageous position than other war contractors. Since they are making their peacetime products, they have had and they will have fewer conversion problems. Apart from the merits of this exemption, there will be interminable debate as to what contracts are subject to the Act.

Still another provision requires the renegotiating agencies to take estimated taxes into account for the purpose of determining excessive profits. This is an anomaly in a measure that is concerned with the establishment of sound prices. It fundamentally changes the character of the renegotiation process from a re-pricing procedure to a super excess-profits tax. It shifts the war contractor's war tax burdens to the Government. More precisely, it transfers the war contractor's war tax load from his own shoulders to those of other taxpayers generally.

Finally, the Senate Finance Committee bill contains a provision requiring the renegotiating agencies to include as a cost in the determination of excess profits carry-backs of unused excess-profits credits and operating losses, as well as amortization recomputations. This provision makes it impossible to conclude a renegotiation agreement within any reasonable time. I do not believe the business man wants to add this element of uncertainty to the many others that beset him in those chaotic times.

It is no exaggeration to say that these amendments emasculate the statute. Their adoption would make it worse than nothing; it would leave a facade of war profit control with no reality behind it. "Business Week," in its December 18, 1943, issue cited the Senate Finance Committee's "very scientific demolition job" on the renegotiation law. "The Committee," it said, "shrewdly avoided voting for outright repeal, knowing Congress would find that hard to take in an election year. Instead, it is trying to get the same result by trimming down the scope of the act and by curtailing the authority of the Price Adjustment Boards."

In this connection, I should like to commend to you the minority report of the Senate Finance Committee. It elaborates on some of the points I have made and discusses in detail and with great force the major defects in the bill recommended by the majority of the Committee.

Under the Committee amendments we should have renegotiation in name, but not in fact,—an unworkable, discriminatory statute that makes many business men vulnerable to the charge of war profiteering and recaptures only a small amount of excessive war profits from one segment of industry.

I doubt if the business men who have urged these changes truly represent business. I am very sure that they are not doing industry any service. I cannot believe that most business men really desire extortionate war profits and a whirlwind of postwar scandal. Let me predict, with Secretary Morgenthau, that if these provisions are enacted into law, "they will come back to plague not only the Congress but the war goods manufacturers who get temporary gain from them." It is interesting to compare the Secretary's words with a recent statement made by Mr. Charles E. Wilson, executive vice-chairman of the War Production Board. Mr.

Wilson said: "This above all is a time when the industrial leaders of America owe it to their country and to themselves . . .to avoid the temptation of sacrificing enduring values for temporary gains. . . ."

CONCLUSION

In closing, I should like to stress that distinction between transient gain and permanent value. The two are often in contrast. The choice lies before us on the tax front and renegotiation front. As the war moves on toward victory we shall have to make many choices between these alternatives. The immediate gain will be tempting. The lasting value will seem ephemeral.

"Present joys are more to flesh and blood
Than a dull prospect of distant good."

My hope is that we will have the spirit, the imagination, and the courage, to resist the pressures of apparent present interests and to make our choices in terms of the enduring interests of the future.