UNITED STATES OF AMERICA

Congressional Record

PROCEEDINGS AND DEBATES OF THE 78th CONGRESS

FIRST SESSION

VOLUME 89—PART 2

MARCH 2, 1943, TO APRIL 5, 1943

(PAGES 1459 TO 2940)

UNITED STATES GOVERNMENT PRINTING OFFICE, WASHINGTON, 1943

withheld at the source entitles her to a 3-percent discount against the 1943 tax to which it is credited. Since she is paid twice a month, and receives $62.50 each pay day, the amount withheld from her will be $9.30, or a total of $111.60 for the last 6 months of 1943, which is approximately one-half the 1943 liability. This would earn a 3-percent discount of $3.35. By prepaying the other half June 15, this stenographer could earn a 6-percent discount on the $108.25 of the 1943 liability which would remain, or $6.50. Thus her total discount would be $3.25 plus $6.50, or $9.75. And in order to earn this small discount, she would have to pay in 1 year, out of a $1,500 income subject to other deductions—such as 5 percent for retirement, 10 percent for War bonds, and so forth—$181 plus $210.25, or a total of $391.25.

Now, in comparison with the $9.75 which this $1,500 stenographer would get, let us see what the man with a million-dollar income would get. His 1942 tax would be $854,616. His 1943 tax, including the net Victory tax liability, would be $899,500. By paying his 1942 tax June 15, and by prepaying his 1943 tax on the same date, he would earn a discount of $53,970.

The chairman of the Ways and Means Committee and other Members have inferred that there is no difference between the withholding provisions of my bill and of the committee bill. There is a vital difference in this respect: The withholding under the committee bill is applied in the first instance to the payment of the past year's liability. Under my bill, the amount withheld is credited in all instances to the current liability. There is just as much difference between the two as between black and white in this respect. The only similarity is in the mechanical details of the withholding. Where we differ is in regard to what the withholding is credited against. I hope that this difference is clear to the House.

I appreciate very much the opportunity to enter into this dicussion on pay-as-you-go taxation. I do not believe anyone can approach this problem with an unbiased viewpoint without reaching the definite conclusion that our tax collections must be placed on a current basis. It is a fundamental change in our income-tax law and one that should be debated and discussed from every angle. The change is of vital importance to the Treasury, as well as the taxpayers. The issue is clearly drawn and I hope that after the debate is over and the vote is taken it can be said of the Members of the House of Representatives that they had the courage to approve a bill that would remove the tax debt that hangs over all taxpayers and make personal income tax payers current.

This personal income tax indebtedness if a threat to the solvency of our Federal Treasury and a millstone around the neck of the taxpayer.

Under our present law personal income tax payers are 1 year behind. That is, they must pay in 1943 a tax based on their 1942 income. If the taxpayer suffers a serious reduction in income, or loses his job, or dies, the tax debt for the prior year becomes a serious problem.

There are two, and only two, methods of getting the taxpayers immediately on a current basis. First, Congress can base this year's tax on this year's income. In other words, move the tax clock ahead 1 year. Second, Congress can try to collect 2 years taxes in 1 year; in other words, levy an impossible burden of double taxation. These are the only two alternatives. Proposals to collect the 1942 liability in whole or in part in addition to current taxes over a period of years also involve some degree of double taxation and also continue the objectionable overhanging income-tax debt.

For several months I have been studying this problem and am convinced that the only practical way to remove the personal income tax debt is to assess the personal income tax on current income and collect it out of current income. If the problem is as serious as I firmly believe it is, our Nation can well afford to pay whatever the cost may be, if any. This fundamental change in our income-tax law is proposed for all years in the future, and the benefits of the change would continue to accrue, both to taxpayers and the Treasury.

Many economists and tax authorities have offered various proposals to get our taxes on a current basis. One of the original sponsors of a pay-as-you-go tax plan and an outstanding tax authority in the United States, Mr. Beardsley Ruml, of New York City, has proposed the plan which has received Nation-wide approval. It is commonly referred to as the Ruml plan. Mr. Ruml is Chairman of the Federal Reserve Board of New York and treasurer of R. H. Macy & Co., Inc. He was first formerly associated with the administrative branch of the Federal Government in 1930 as a member of Col. Arthur Wood's committee on employment, and more recently as adviser of the National Resources Planning Board. He has also served as a member of the advisory committee of the Division of Cultural Relations of the Department of State, of the advisory committee of the Coordinator of Inter-American Affairs, and of the advisory council of the Department of Agriculture.

Mr. Chairman, before the end of the Seventy-seventh Congress I began studying the problems connected with getting our tax payments on a current basis. I approached this subject with an open mind and studied every plan I could secure. I can definitely state that, in my opinion, just criticism can be levied at any or all of them. It was after this study and research that I reached the conclusion that the Ruml plan offered the best solution to our problem of getting taxpayers current.

Either the tax clock must be advanced 1 year or there must be a collection of 2 years' taxes in 1 year. My knowledge of the economic problems of the American people convince me that our taxpayers cannot pay 2 years' taxes in 1. In my study of this problem I discovered many interesting things concerning our income-tax law. Historically, our Federal income-tax law goes back to a bill signed by President Lincoln on August 5, 1861. It was first announced as a war-revenue measure and even at that early date one provision of the act provided for collections by withholding at the source. The act was carried on the statute books for several years. In its early stages it was definitely an excise tax or a duty and so construed by the courts. A most informative statement in regard to the early history of the income-tax law was recently written by Mr. F. Morse Hubbard, formerly of the legislative drafting research fund of Columbia University, and a former legislative draftsman in the Treasury Department. This compilation of information concerning our income-tax law is so well written that I am making it a part of my statement and the record:

I. THE INCOME TAX IS AN EXCISE TAX, AND INCOME IS MERELY THE BASIS FOR DETERMINING ITS AMOUNT

The first Federal income tax law was approved by President Lincoln on August 5, 1861, a little less than 4 months after the bombardment of Fort Sumter and the President's call for 75,000 volunteers, and less than a month after the disaster at Bull Run. It was distinctly a war-revenue measure. The act of 1861 (12 Stat. 292) provided for a tax to be levied, assessed, and collected in the year 1862, the tax to be based on income for the "preceding" year, that is, the year 1861. This tax, which was due and payable on or before June 30, 1862, was levied only for that 1 year.

In 1862, in order to meet the need for continued war revenues, Congress passed the second income-tax law. This act took effect on July 1, 1862, the day after the tax under the act of 1861 expired. The act of 1862 (12 Stat. 432) which used the word "duty" instead of "tax," provided that this duty should be levied, collected, and paid in the year 1863 and in each year thereafter until and including the year 1866 "and no longer" (sec. 92). Like the act of 1861 it provided that the tax (or duty) collected in each year should be based on the income for the "preceding" year (sec. 91). At the same time it contained a provision for withholding at the source, which will be referred to later on.

The general pattern of the act of 1862 was followed in the subsequent income tax laws of this period, namely, the act of June 30, 1864 (13 Stat. 223), and its amendments, and the act of July 14, 1870 (16 Stat. 256). Under each of these acts the tax to be paid in any given year was based on the income for the preceding year, provision was made for withholding at the source, and the tax was to be in effect only for a limited period. Under the act of 1864 the tax terminated in 1870, and under the act of 1870 the tax terminated in 1872.

The income on which the tax was based was defined as income from all sources, "whether derived from any kind of property, rents, interests, dividends, salaries, or from any profession, trade, employment, or vocation" (act of 1864, sec. 116). Thus investment income, as well as other kinds of income, was included in the basis for measuring the tax.

In sustaining the Civil War income tax laws, the Supreme Court held that the tax based on income was not a direct tax but was an excise or duty and as such did not require apportionment among the States. *Springer v. United States* ((1880) 102 U. S. 586). This decision, rendered after the income tax had been thoroughly tested for a period of 10 years, represents a deliberate determination as to the fundamental nature of the tax.

The true character of the income tax was at the outset so firmly fixed in the minds of those charged with its administration that for 6 years the Treasury Department held that if a person died at any time between

January 1 of one year and the date when his return was due in the following year the income for such period was not subject to tax, even though he may have made a return of income before his death in advance of the due date (T. D. June 9, 1865, 2 Internal Revenue Record 54). This rule was not changed until 1867, when it was held that such income was subject to the tax and should be returned by the executor or administrator (T. D. Apr. 6, 1867, 5 Internal Revenue Record 109; T. D. Jan. 1, 1868, 7 Internal Revenue Record 59). See also *Mandell* v. *Pierce* (C. C. D. Mass. 1868, 16 Fed. Cas. 576). The change was doubtless prompted by two important considerations; first, the taxes expired by definite limitation within a very few years; and, second, persons whose tax had been withheld at the source would already have paid their tax up to the date of death. At any rate, the change did not involve any modification in the concept of the income tax as an excise tax based on income.

After a lapse of about a quarter of a century Congress again passed an income-tax law. The act of 1894 (28 Stat. 509, 553; Aug. 27, 1894) provided for a tax to be levied, collected, and paid "from and after" January 1, 1895, "and until the 1st day of January 1900" (sec. 27). Like the Civil War acts it provided that the tax should be based on the "income received in the preceding calendar year." Although the Supreme Court held this portion of the act to be unconstitutional, it still recognized that the income tax was in essence an excise tax. The Court said that a tax on income from business, privileges, or employments, standing by itself, would be valid as an excise tax; but the tax on investment income was held to be invalid because the Court regarded a tax based on income from property as a tax on the property itself and therefore a direct tax which must be apportioned among the States (*Pollock* v. *Farmers' Loan and Trust Co.* (1895), 157 U. S. 429; 158 U. S. 601). The Court said that to sustain a portion of the tax while declaring the rest invalid, "would leave the burden of the tax to be borne by professions, trades, employments, or vocations; and in that way what was intended as a tax on capital would remain, in substance, a tax on occupations and labor. We cannot believe that such was the intention of Congress" (158 U. S. 601, 637). So the entire portion of the act relating to income tax was declared invalid.[1]

There are still those who think that in this case the Court went further than necessary in treating a tax based on income from property as a tax on property itself, and that in any event the excise-tax principle should have been applied to rents and other investment income, as was done under the Civil War acts. In other words, the making and holding of investments, while perhaps not technically a business, is, at least, a kind of activity or privilege which can properly be subjected to an excise tax measured by reference to the income derived therefrom.

That investment income may be included as a part of the basis for measuring an excise tax was recognized by Congress in the act of August 5, 1909 (36 Stat. 11, 112). This act provided "That every corporation * * * shall be subject to pay annually a special excise tax with respect to the carrying on or doing business by such corporation, * * * equivalent to 1 percent upon the entire net income over and above $5,000 received by it from all sources during such year, exclusive of amounts received by it as dividends upon stock of other corporations * * * subject to the tax hereby imposed; * * *." Certain corporations, such as religious, charitable, and educational organizations, etc., were specifically exempted from the tax.

The tax imposed by this act was really an income tax in that it was based on net income, but was given the correct designation of "excise tax." It was imposed with respect to carrying on or doing business; and it should be noted that the basis was net income from all sources, except dividends from other corporations subject to the tax. Such dividends were excepted not because they constituted investment income but because they represented income which had already been taxed. The sole test of taxability under this act was whether a corporation was engaged in business. If it was so engaged, then all the income (except dividends), including investment income as well as strictly business income, was used in measuring the tax. The Supreme Court held that the fact that the tax was measured by net income, and that income from nontaxable property or property not used in business was included in computing net income, did not prevent the tax from being construed as an excise tax which did not require apportionment. *Flint* v. *Stone Tracy Co. et al.* ((1911) 220 U. S. 107).

So far as the objections raised in the Pollock case are concerned, the principle applied to corporations under the act of 1909 with the approval of the Supreme Court might have been extended to individuals engaged in business. In that way investment income of most individuals as well as of corporations could doubtless have been brought under the terms of the act. And the field of income could have been completely covered by applying the principle that the ownership and management of investment property is an activity or privilege with respect to which Congress may impose an excise.[2]

However that may be, Congress chose to remove all doubt by an amendment to the Constitution. The resolution embodying the proposed amendment (S. J. Res. 40, 36 Stat. 184; 61st Cong., 1st sess.) was deposited in the Department of State on July 31, 1909, a few days before the act of 1909 was approved by the President. The amendment was duly ratified and became effective as the sixteenth amendment on February 25, 1913. (Secretary of State's Certificate of Adoption, 37 Stat. 1785).

The sixteenth amendment authorizes the taxation of income "from whatever source derived"—thus taking in investment income—"without apportionment among the several States." The Supreme Court has held that the sixteenth amendment did not extend the taxing power of the United States to new or excepted subjects but merely removed the necessity which might otherwise exist for an apportionment among the States of taxes laid on income whether it be derived from one source or another.[3] So the amendment made it possible to bring investment income within the scope of a general income-tax law, but did not change the character of the tax. It is still fundamentally an excise or duty with respect to the privilege of carrying on any activity or owning any property which produces income.

The income tax is, therefore, not a tax on income as such. It is an excise tax with respect to certain activities and privileges which is measured by reference to the income which they produce. The income is not the subject of the tax: it is the basis for determining the amount of tax.[4]

The purpose of the income tax is to raise revenue in the year of its levy. It is a method by which some of us make annual payments on account of the governmental expenses and the public debt of all of us—contributions to a common fund to preserve the blessings of liberty. The great French political philosopher and jurist, Montesquieu, stated the fundamental principles of taxation as follows:

"The revenues of the State are a portion that each subject gives of his property in order to secure, or to have the agreeable enjoyment of, the remainder." (Spirit of Laws, book XIII, chap. 1.)

The income tax is now a permanent part of our tax structure, and is designed to provide for such contributions, or payments, year after year, indefinitely. The tax "for" any given year is the tax which is to provide revenue for that year. Strictly speaking, then, the "1942 income tax" was the tax payable in 1942; and the "1943 income tax" is the tax payable in 1943.

The amount of the payments for any year is determined by applying certain rates to a specified basis. Both of these factors are matters of legislative policy. Congress may fix any rates which are not confiscatory and may adopt any basis which is reasonable. Hitherto the previous year's income has been used as the basis. But the basis, as well as the rates, may be changed at any time. In these matters of policy, the Constitution, both before and since the Sixteenth Amendment, has left to Congress practically unrestricted freedom of choice.[5]

Under our existing Federal income-tax law which has been operating for many years, the amount of income tax payable in any year by an individual taxpayer is based, not upon the income of the tax-paying year, but upon the income of the preceding year. This method whereby

---

[1] It must be remembered that the Court was not appraising economic theories, but was construing provisions of the Constitution. The first related to the power of Congress:

"To lay and collect taxes, duties, imposts, and excises, to pay the debts and provide for the common defence and general welfare of the United States; but all duties, imposts, and excises shall be uniform throughout the United States" (art. I, sec. 8, subdiv. 1).

The second was the provision that:

"No capitation, or other direct, tax shall be laid, unless in proportion to the census of enumeration herein before directed to be taken" (art. I, sec. 9, subdiv. 4).

Thus the Constitution made a distinction between "taxes" on the one hand, and "duties, imposts, and excises" on the other. Uniformity was required in the case of the latter, whereas apportionment according to population was required only in the case of "taxes." The only taxes generally regarded as "direct" were poll taxes and taxes on property. The only direct taxes which had been imposed by Congress prior to 1894 were taxes on lands, houses, and slaves. See Foster and Abbott, A Treatise on the Federal Income Tax under the act of 1894, pp. 27 ff. The Court had no difficulty in classifying a tax on income as an excise tax. Its objection to the act of 1894 was doubtless based on the theory that a tax on rents was not in reality an income tax but was a direct tax on lands and buildings. (See Foster and Abbott, op. cit., pp. 117–118.)

[2] That such is the case is clearly indicated by the recent provision in the Revenue Act of 1942 which allows deductions for expenses incurred in the management of investments (sec. 121). The retroactivity of this provision suggests not merely the declaration of a new policy but the recognition of a fundamental principle.

[3] *Brushaber* v. *Union Pacific Railroad Co.* ((1916) 240 U. S. 1); *William E. Peck and Co.* v. *Lowe* ((1918 247 U. S. 165); *Eisner* v. *Macomber* ((1920) and 252 U. S. 189).

[4] If the tax should be construed as a tax on income as a specific fund the disappearance of the fund before the date of assessment would prevent the collection of the tax. (See Foster and Abbott, op. cit., p. 85.)

[5] "If the income is merely the measure of the tax, it is clearly quite immaterial whether the income that is adopted as a measure is that of the past, or of the present, or of the future, provided only it is practically ascertainable." (Foster and Abbott, op. cit., p. 87.)

a taxpayer must use the previous year's income as a base for the next year's tax payments results in many inequalities and injustices. When the tax rates were low and the exemptions very large these injustices were felt only in a small number of cases. Under greatly increased tax rates and reduced exemptions, the problems presented by this system have multiplied to a degree that not only works a great hardship on large numbers of taxpayers, but might readily prove very embarrassing to the Federal Treasury.

Few people realized how much money they owed the Government for taxes on last year's income until they made out their income-tax returns. There seems to be a prevailing impression that when you pay your quarterly income-tax payments everything is paid until the taxes for the next quarter are due, or at least they assume they are not in debt to the Federal Government. This is an erroneous impression. The fact is that every citizen is indebted to the Federal Government for last year's taxes until they are fully paid, and more than that, the taxpayer is indebted to the Federal Government for the accrued taxes due in the year in which he is paying income taxes.

The income-tax debt hurts most when sickness strikes, when a shift of employment reduces your salary or when you have lost your regular income.

Under the present plan of taxation a man this year pays out of this year's income the taxes assessed against last year's income. In 1944 he is required to pay a tax out of his 1944 income, but based upon his income for 1943. Under the present system it can truthfully be said that a dead man pays income taxes because his estate is liable for income taxes accrued for the year previous to his death. Such a situation—to put it mildly—is not one in which we as a Nation can take pride.

It is true that a man does not have to die to face a similar anomalous position. Any man who at the end of the year has the misfortune to cease to receive an income due to an accident, illness, or other misfortune which might disqualify him from his earning capacity is, under our present law, compelled during that year to pay an income tax on last year's income. Assessing an income tax to be paid in 1 year upon the income of a different year departs widely from the ability-to-pay principle of taxation. Our income-tax law is based on the sound philosophy of ability to pay—that is, it was based on that sound philosophy in 1913, when it was first approved by our Nation. Theoretically, that principle holds true today, but from a practical standpoint I am not so certain that it will stand analysis. Demanding payment of income taxes from dead men or those who have ceased to have income is a complete violation of such a principle. Ability to pay relates to the ability in the year in which payment must be made and not to the condition in some other year. Theoretically, a man sets aside a part of his income for the tax that the law requires him to pay in the following year. This may be good theory, but does not work out in practice. It was the intention of the framers of our income-tax law in 1913 to use 1913 merely as a base for the tax payments to be made out of the next year's income. This is the practical effect of the law today. The fact that the law now allows all of the year 1943 to pay the assessment on 1942 incomes clearly indicates that Congress intends the tax to be paid out of 1943 income.

I do not know of any better illustration of how setting the tax clock ahead 1 year will work than to refer to our distinguished chairman who was here when the Congress passed the first income tax law in 1913. He was a Member of Congress at that time. Bear this in mind, that if we had had the Ruml plan in 1914 and moved the tax clock up 1 year, he would not be $1 better off today, as far as tax money is concerned; he would not have gained a dollar and he will never gain a dollar until his income ceases or until his income decreases.

Mr. DOUGHTON. Mr. Chairman, will the gentleman yield? He has referred to me.

Mr. CARLSON of Kansas. I yield to our distinguished chairman.

Mr. DOUGHTON. If my tax is forgiven for 1942, when will it ever be paid? When will the Government ever get it? The gentleman has gone too far back. Come right down to brass tacks. Say now my tax in 1942 is forgiven and wiped out, $2,500. Then I would keep that much money, would I not? When would the Government ever have me pay it? I would keep it in my pocket. When would the Government ever get it? That is a fair question.

Mr. CARLSON of Kansas. The distinguished chairman paid his taxes in 1941. He paid them on the basis of earnings back in 1940. He paid his taxes in 1942 on his 1941 income. There is no question about that. We pay taxes every year. He does not gain and would not gain anything until his income decreases or ceases.

Mr. DOUGHTON. I did not pay my tax in 1913 because it was not due until the next year.

Mr. CARLSON of Kansas. That is right.

Mr. DOUGHTON. It was not due. I do not ordinarily pay my debts until they are due, but I do try to pay them when they are due. I do not try to dodge them or run out on them. I pay them.

Mr. CARLSON of Kansas. The chairman knows that the taxes he paid in 1914 were based on his income for 1913. That was the standard they set up; that is what they determined he should pay a tax on. But he paid them out of 1914 income.

Mr. DOUGHTON. I had no notion of interrupting the gentleman because he is a very fine and able member of this committee.

Mr. CARLSON of Kansas. I thank the gentleman for his compliment.

Mr. DOUGHTON. However, as long as the gentleman referred to me I think he ought to answer my question. If I get out of my 1942 tax, if it is abated, when would I ever pay it? When would the Government get it?

Mr. CARLSON of Kansas. The chairman will never receive any tax benefit from this program until his income ceases or his income declines; not 1 cent.

Mr. DOUGHTON. I challenge that statement absolutely. If I keep it in my pocket, I have benefited.

Mr. CARLSON of Kansas. The gentleman does not have any money in his pocket in this at all, because he will still be paying tax in 1943 under my bill.

Mr. DOUGHTON. The Government never gets it.

Mr. KNUTSON. Mr. Chairman, will the gentleman yield?

Mr. CARLSON of Kansas. I yield to the gentleman from Minnesota.

Mr. KNUTSON. Will the gentleman inform the House just what his taxes would be this year under existing law and what they would be under his bill?

Mr. CARLSON of Kansas. I will make this statement because it seems so clear. If there is any man on this floor who thinks he is going to have some tax money left in his pocket if he votes for this bill of mine, he is just mistaken for this reason. You do not get out of a dollar of tax. You pay just the same taxes in 1943 under my bill that you would have paid on the 1942 liability in 1943 under the present law. The only difference is that it is your current year's taxes under my bill. You are current instead of being 1 year behind.

Mr. GEARHART. Mr. Chairman, will the gentleman yield?

Mr. CARLSON of Kansas. I yield to the gentleman from California.

Mr. GEARHART. You will pay the same taxes, but you will have had 2 years of income—1 year's tax but 2 years' income. Is that not correct?

Mr. CARLSON of Kansas. I do not agree with the gentleman at all. The gentleman can figure 2 years' income out of that. I wish I could, but I cannot. The fact is that a tax was collected out of the 1942 income measured by the 1941 income.

Mr. GEARHART. You will have the income of 1942, in the gentleman's case $10,000. You will not pay any tax on that. You will have the income of 1943, and you will pay the tax on that alone. That is $20,000 of income, but a tax on only $10,000.

Mr. CARLSON of Kansas. The gentleman and I have gone over this before. He forgets that in 1941 I paid taxes on my 1940 income. In 1942 I paid on my 1941 income. I did not skip any tax years. I did not gain anything, and I will not gain this year.

Mr. AUGUST H. ANDRESEN. Mr. Chairman, will the gentleman yield?

Mr. CARLSON of Kansas. I yield to the gentleman from Minnesota.

Mr. AUGUST H. ANDRESEN. The gentleman has referred to Congress either lowering or raising the rate. There is no reason why Congress cannot pass another tax bill in October of this year and raise the rate to 40 percent, is there?

Mr. CARLSON of Kansas. No; there is no reason why it cannot. We do it continually.

Miss SUMNER of Illinois. Mr. Chairman, will the gentleman yield?