

## THE REVENUE BILL OF 1941

SEPTEMBER 2, 1941.—Ordered to be printed

Mr. GEORGE, from the Committee on Finance, submitted the following

### REPORT

[To accompany H. R. 5417]

The Committee on Finance, to whom was referred the bill (H. R. 5417) to provide revenue, and for other purposes, having had the same under consideration, report favorably thereon with certain amendments and, as amended, recommend that the bill do pass.

#### ESTIMATES OF REVENUE

The bill as passed by the House was estimated to produce added tax revenue of \$3,216,400,000 annually. The amendments made by your committee add \$463,400,000 to this figure, bringing the total additional annual yield to \$3,679,800,000.

The additional revenue to be secured by your committee bill over that of the House bill comes principally from the following sources: corporation normal tax \$19,000,000, corporation surtax \$120,500,000, and individual income tax \$332,400,000.

The following table sets out the estimated yields of the House bill and the Finance Committee bill, with the increase or decrease of the Finance Committee bill over the House bill. It should be noted that the figures contemplate a year of full operation.

imposed it would be desirable to provide for an exemption of billboards the use of which is donated to the Federal Government for the purpose of aiding it in recruiting for the military and naval forces and in the sale of its securities. It is regarded also as a tax regulatory in some degree of a matter which might preferably be left in the hands of State and local authorities.

#### 15. RADIO BROADCASTING STATIONS AND NETWORKS

The tax imposed by the House bill on persons, operating radio broadcasting stations or engaging in net work broadcasting has been stricken out. The reasons in consideration of which the Ways and Means Committee recommended and the House adopted the tax are recognized as having considerable force, but it is believed that the peculiar characteristics of this possible source of revenue require careful study before either the proper basis or rate of tax can be satisfactorily determined. It is the opinion of the committee also that the tax imposed by the House bill would operate with some unjustified discrimination against this particular form of advertising.

#### 16. COCONUT OIL

The committee added to the House bill a section amending chapter 21 of the Internal Revenue Code by adding at the end thereof a new section, numbered 2483, which provides, under certain limitations, that the processing tax provided for in that chapter collected with respect to coconut oil wholly of the production of Guam or American Samoa or produced from materials wholly of the growth or production of those islands shall be held as separate funds and paid into their respective treasuries. The collections affected are those made after the date of the enactment of the bill.

The provision is similar to an existing provision, section 2476 of the Internal Revenue Code, governing the disposition of collections from the processing tax on coconut oil wholly of Philippine production or produced from materials wholly of Philippine growth or production.

#### VI. NONESSENTIAL FEDERAL EXPENDITURES

This amendment establishes a committee to investigate non-essential Federal expenditures. The committee is to be composed of (a) three members of the Senate Committee on Finance and three members of the Senate Committee on Appropriations, to be appointed by the President of the Senate; (b) three members of the House Committee on Ways and Means, and three members of the House Committee on Appropriations, to be appointed by the Speaker of the House of Representatives; and (c) the Secretary of the Treasury and the Director of the Bureau of the Budget. It shall be the duty of such committee to make a complete study and investigation of all expenditures of the Federal Government with a view to recommending the elimination or reduction of all such expenditures deemed to be nonessential. The committee shall report to the President and to the Congress the result of its study together with its recommendations at the earliest practicable date. It is given the authority and powers

commonly given to similar committees of the Senate and will operate under an appropriation not to exceed \$10,000.

Paralleling this action, your committee also adopted a committee resolution calling upon the Director of the Budget, under the Budget and Accounting Act of 1920, to submit to the chairman of your committee a report showing how nondefense and nonessential budget items may be reduced by alternative totals of (1) \$1,000,000,000; (2) \$1,500,000,000; (3) \$2,000,000,000. Such report would be available not only to the appropriate committees of the House and Senate but to the committee established under this amendment. The action of your committee in this respect is in line with repeated recommendations of the Secretary of the Treasury before both the Committee on Ways and Means of the House and your committee.

#### DETAILED DISCUSSION OF THE PROVISIONS OF THE BILL

##### TITLE I—INDIVIDUAL AND CORPORATION INCOME TAXES

##### SECTION 101. SURTAX ON INDIVIDUALS

Under the House bill, the surtaxes apply upon the entire surtax net income and hence the exemption from surtax of the first \$4,000 of surtax net income found in existing law is abolished. The lowest surtax bracket rate is 5 percent as compared with 4 percent under existing law. The surtaxes are increased in all brackets up to \$750,000 and from that point the rates of existing law are retained. While the rates attributable to surtax net income in excess of \$750,000 are not increased, surtaxes payable by taxpayers in these upper brackets are increased by reason of the higher rates in the lower brackets.

Under the bill as reported by your committee, further increases in the surtax rates are made as the result of the integration of the defense tax and the surtax rates. The lowest surtax bracket rate is therefore 6 percent as compared with 5 percent under the House bill and the rates on income in excess of \$750,000 are likewise increased, the highest rate being 77 percent as compared with the 75 percent contained in existing law and in the House bill.

##### SECTION 102. OPTIONAL TAX ON INDIVIDUALS WITH CERTAIN GROSS INCOME OF \$3,000 OR LESS

Section 102 of the bill adds to the Internal Revenue Code a new supplement designated "Supplement T" and comprising sections 400 to 404, inclusive. No comparable provisions are contained in the House bill.

Section 400 of Supplement T imposes a tax upon individuals whose gross income is \$3,000 or less and consists wholly of salary, wages, compensation for personal services, dividends, interest, rents, annuities, or royalties. The tax is imposed at the election of the taxpayer and is in lieu of the tax imposed by sections 11 and 12. If the taxpayer's gross income exceeds \$3,000 or if he has income from any source, or of any class, other than those specified in section 400, he may not avail himself of the election. For instance, the section is not available to a taxpayer who has income from the conduct of a business, or from a partnership or trust, or who has realized gain from the sale or exchange of property. If a husband and wife file

separate returns under the section, the limitation of \$3,000 applies to the gross income of each; if they file a joint return, the limitation applies to the combined gross income of the spouses.

The amount of the tax imposed on specified amounts of gross income is determined by reference to the schedule set forth in section 400, a duplicate of which will be printed on the reverse of the form prescribed for making a return of the tax under such section. Gross incomes are grouped in blocks of \$25 with the same tax payable for all incomes falling within the particular block. The tax imposed is the amount appearing in column 3 or 4 opposite the particular block. If the taxpayer is a single person who is not the head of a family, the tax imposed is the amount set forth in column 3. If the taxpayer is the head of a family or a married person, the tax imposed is the amount set forth in column 4. If a taxpayer has one or more dependents, he merely subtracts from his gross income \$400 for each such dependent and finds the block in which falls the reduced amount.

The amount of the tax imposed in the various blocks is the average of the tax imposed by sections 11 and 12 on the lower and upper limits of the blocks, reduced by 10 percent as an allowance in lieu of deductions from gross income. The schedule takes into account a personal exemption of \$750 for a single person and \$1,500 for a married person or the head of a family, the same as allowed by section 25 in respect of the tax imposed by sections 11 and 12.

Section 401 prescribes certain rules to be observed in the application of the schedule set forth in section 400. The section states that only a married person living with husband or wife is to be deemed a "married person" for the purposes of Supplement T, and specifically defines a "dependent." For the purposes of this Supplement, the status of a taxpayer as a "married person," "head of a family," or "dependent" is to be determined as of the last day of the taxable year. Consequently, the provisions of section 25 (b) (3) relating to the apportionment of the personal exemption and credit for dependents by reason of a change of status during the taxable year have no application in ascertaining the amount of the tax under section 400. Thus, if a taxpayer has on the last day of the taxable year a dependent within the meaning of the definition contained in section 401, he is entitled to reduce his gross income by \$400 in order to ascertain the amount of tax, and it is immaterial that the dependent may have occupied such status for only a portion of the taxable year.

Section 401 provides that if a husband and wife living together file separate returns under section 400, each shall be treated as a single person. Thus, in effect, each receives the benefit of one-half the personal exemption allowed a husband and wife. If they file separate returns and one spouse elects to be taxed under section 400, such spouse is taxed as a single person and in effect receives the benefit of one-half the personal exemption allowed a married person. The personal exemption and credit for dependents of the spouse who does not elect to be taxed under section 400 is determined under the provisions of section 25 (b) and is not governed by his status on the last day of the taxable year. Under the provisions of section 25 (b), as amended by section 111 of the bill, such spouse will be allowed for that portion of the taxable year during which he occupied the status of a married person living with husband or wife one-half of the personal

exemption allowed a married person for such portion of the taxable year.

For example, H, a widower having two dependents, marries W, a single person, on July 1, 1941. For the calendar year 1941, they filed separate returns and W elects to be taxed under section 400. W is taxed as a single person and, since she receives the benefit of a \$750 exemption, she in effect receives the benefit of half the marital exemption of \$750 for the second half of the year by reason of her status on the last day of the taxable year. H, who is taxed under sections 11 and 12, is subject to the provisions of section 25 (b) (3) requiring an apportionment of the personal exemption and credit for dependents by reason of a change of status during the taxable year. H qualifies as the head of a family for the first 6 months of the taxable year and as a married person living with husband or wife for the last 6 months. Accordingly, his personal exemption is six-twelfths of \$1,500 for the first half of the year plus six-twelfths of \$750 for the second half, or \$1,125. Inasmuch as his status as the head of a family arises from the fact that he maintained a home for two dependent children, the credit for one of such dependents for the first 6 months of the taxable year is disallowed. He is therefore entitled to a credit for one dependent for the first 6 months and a credit for two dependents for the last 6 months. His credit for dependents is therefore \$600.

Section 401 also provides that a married person who is not the head of a family and is not living with husband or wife on the last day of the taxable year shall be subject to the tax imposed upon a single person.

An election to be taxed under section 400 can be made only by affirmative action of the taxpayer. Section 402 provides that the election to be taxed under section 400 shall be made by filing a return for the taxable year on the form prescribed for making a return of the tax under this section. Such an election once made is irrevocable. Consequently, such election may not be changed by an amended return. Moreover, if for any taxable year the taxpayer makes a return without regard to this supplement he may not thereafter elect for such taxable year to have his tax computed under this supplement. If the taxpayer fails to file a return for the taxable year and the Commissioner or the collector makes a return under the authority of section 3612, such return shall be made without regard to the provisions of this supplement and the taxpayer shall be deemed to have lost his right to make an election for the taxable year under this supplement.

Section 403 provides that the provisions of section 31 (relating to foreign tax credit) and section 32 (relating to taxes withheld at source) shall not apply with respect to the tax imposed by Supplement T. This provision is necessary in the interest of simplicity. If substantial amounts of either such credit are involved, the taxpayer should make his return under the general provisions of the statute.

Section 404 provides that Supplement T shall not apply to a non-resident alien individual, or an estate or trust. This provision is also necessitated in the interest of simplicity. Such taxpayers are subject to special provisions of the statute that are not readily adaptable to the method of taxation employed in Supplement T.

Section 102 (b) of the bill amends sections 11 and 12 of the code to include cross-references to section 400.

ly nonresident foreign corporations organized under the laws of any country in North, Central, or South America, or in the West Indies, or of Newfoundland.

**SECTION 110. DEFENSE TAX RATES ON PERSONAL HOLDING COMPANIES AND TRANSFERS TO AVOID INCOME TAX INCORPORATED IN RATE SCHEDULES**

This section corresponds to section 109 of the House bill, which amends section 500 (b) and section 1250 (b) of the Internal Revenue Code in order to make permanent the defense taxes imposed by such sections on personal holding companies and on transfers to avoid income tax. The bill as reported by your committee repeals these sections, and the taxes imposed by them are integrated with the tax on personal holding companies and the tax on transfers to avoid income tax.

**SECTION 111. PERSONAL EXEMPTION**

This section, for which there is no corresponding provision in the House bill, amends section 25 (b) (1) by lowering the personal exemption of married persons from \$2,000 to \$1,500 and the personal exemption of single persons from \$800 to \$750. The section also amends section 214 of the Internal Revenue Code (relating to personal exemption of nonresident alien individuals) and section 251 (f) of the Internal Revenue Code (relating to personal exemption of citizens entitled to the benefits of section 251) by striking out \$800 and inserting in lieu thereof \$750 in conformity with the changes made in section 25 (b).

This section further amends section 25 (b) (1) relative to the personal exemption of a married person whose spouse files a separate return under Supplement T, added by section 102 of the bill.

**SECTION 112. RETURNS OF INCOME TAX**

In accordance with the change in the personal exemption made by section 111 of the bill, this section amends section 51 (a) of the Internal Revenue Code to require a return in the case of any individual whose gross income is equal to or in excess of the personal exemption as reduced by section 111. Thus, a return is required from any individual who is single or married but not living with husband or wife if his gross income is \$750 or over, and from a married individual living with husband or wife if having a gross income of \$1,500 or over if the other spouse has no gross income, or having a gross income together with the other spouse of \$1,500 or over.

A similar change has been made with respect to fiduciary returns and with respect to the amount of payments to individuals which requires an information return from the payor of the income.

**SECTION 113. CREDIT FOR DEPENDENTS**

This section is the same as section 110 of the House bill which amends section 25 (b) (2) of the Internal Revenue Code relative to the credit for dependents.

In the case of the head of a family or a married person living with husband or wife, the existing law provides as a credit against net

income a personal exemption plus \$400 for each dependent other than husband or wife. Under these provisions, a married person living with husband or wife and having no dependents receives as a maximum credit the personal exemption. On the other hand, an unmarried person maintaining a home for a person who also qualifies as a dependent may receive in addition to the same personal exemption a credit for \$400 for such dependent. The proposed legislation disallows the credit for one dependent in cases where the taxpayer's status as head of a family is occasioned solely by the existence of one or more of such dependents. The amendment will not affect any case except one in which the taxpayer occupies the status as head of a family solely by reason of the existence of a person for whom he is also entitled to the credit for a dependent. For instance, it will not operate to reduce the credit in the case where a widower is maintaining a home for two children, only one of whom qualifies as a dependent. In such case, the status as head of a family is not occasioned solely by existence of the child in respect of whom the credit of \$400 is allowed and consequently the taxpayer may be entitled to the personal exemption allowed the head of a family plus the \$400 credit, the same as under existing law.

**SECTION 114. NON-INTEREST-BEARING OBLIGATIONS ISSUED AT DISCOUNT**

This is the same as section 111 of the House bill and provides that any taxpayer who owns any non-interest-bearing obligations issued at a discount and redeemable for fixed amounts increasing at stated intervals and who, under the method of accounting used by him in computing his net income, is not permitted to report the increment in value of such obligations as it accrues, may, at his election, treat such increment in value as constituting income to him in the year in which it accrues rather than in the year in which the obligations are disposed of, redeemed, or paid at maturity. Under existing law a taxpayer on the accrual basis who owns, for example, non-interest-bearing United States defense bonds is required to report the increment as it accrues, whereas a taxpayer on the cash basis who owns such defense bonds is required to treat the entire increment in value as being income received in the year of redemption or maturity. Therefore, with respect to such non-interest-bearing United States defense bonds, the effect of this section is to extend, at the election of the taxpayer, the accrual method to a taxpayer on the cash basis, but only for the limited purpose of reporting the increment in value of such bonds as it accrues.

The election provided for in this section must be made in the taxpayer's return, and may be made for any taxable year beginning after December 31, 1940. When so made with respect to any obligation, the election shall apply also to all obligations of the type described in this section owned by the taxpayer or thereafter acquired by him. The election applies to the taxable year for which such return is filed and is binding for all subsequent taxable years unless the Commissioner permits the taxpayer, subject to such conditions as the Commissioner deems necessary, to change to a different method of reporting income from such bonds. Although the election, once made, is binding upon the taxpayer, it would not apply to a transferee of such