I submit for your consideration that just as a department store, wanting to induce customers to spend money in their store, must not only assemble a stock considered proper for customers to want, but must undertake the very difficult affirmative task of making sure that customers will want the goods and will pay money for them, so a government must not only make a determination of the tax, but also, having determined it in a way appropriate to the purpose of settlement, must follow through to the other part of the tax collector's job—the even more difficult and useful task of conciliating the inevitable differences.

The failure of the Treasury in general to devise constructive and affirmative methods of so determining the taxes and then so explaining the determinations that any reasonable business man would decide to give up dispute and pay the tax, is undoubtedly a source of a very massive part of the whole administrative nightmare of the old excess profits taxes,—a hard experience for the government, and a hard experience for the taxpayer which continued from the year 1918 until a very few years ago.

It is true enough that an excess profits tax may present hundreds of technical questions of law and of fact, many of them difficult, and that analysis of each question separately is necessary, in the light of existing and expected precedents. But it also remains true that the whole case is the real unit, not each issue, and that the real problem is not to vindicate set principles or precedents, but to deal with the case as a whole and get rid of it.

Everyone interested in this country's revenue system is glad to realize, I think, that some progress has been made since the World War period toward a Treasury policy founded on these truths, but unless our Government is able to go much further along these lines, these various difficulties which so expensively delayed settlement of those taxes will threaten any high rate tax enacted now. The fact is that high rate taxes of this character demand degrees of wisdom, independence, and courage in administration that have seldom been observable, for long at a time, in any of this country's governmental activities. The Government certainly needs to profit by observing the difference between the lack of success of the department store that gets out of patience with customers for not buying, and the success of the one that cheerfully takes customers exactly as they are, has goods that they will want, and ingeniously deals with them as human beings. The latter type not only succeeds, but, significantly in this connection, does not have to lower prices.
Classes of Technical Difficulties

Turning from this type of difficulties to the technical ones that were inherent in the text of the law as it was enacted by Congress,—one has only to look at the regulations issued regarding them, and the voluminous indexes of the published rulings, to see what a multitude of controversy-breeding technical questions have to be dealt with.

There is not time now to say more than that the more serious technical questions brought into prominence by the old high rate taxes can be classified in five groups, each one a world in itself:

1. Those affecting the determination of gross and net income, not only for the taxable year but for earlier test periods.
2. Those affecting the highly technical concept of invested capital as defined in the law,—again both as to the test years and as to the taxable year.
3. Those met with in determining the excess profits tax rate under the so-called "special relief provisions" of those earlier laws.
4. Those involved in determining whether certain corporations were exempt from income tax by reason of being personal service corporations.
5. A variety of questions arising from provisions concerning consolidated returns—mentioned by Mr. Eyerly.

To try to list a few of the troubles met with under each one of those general topics would be misleading, because it would give color to the wholly unfounded assumption that you can make a list of the more serious problems, then draft a law that corrects each one of those difficulties—and that thus you will have a good law. You hear that assumption relied on by some legislators in Washington, but no high rate tax can be dealt with in that way. The reason is that no one can foresee just where, in the illimitable variety of business problems, tax trouble is going to break out next. It can't be done. And the most difficult cases to dispose of for good are the ones that produce excessive hardship on the taxpayer, due to peculiar conditions not thought of when the law was drafted; and the draftsman or the group of draftsmen who hopefully believe that they have foreseen and corrected the major inequities in such a law are simply fooling themselves.
Complication Inevitable in High-Rate Tax Laws

Now, desperately hard as it was to administer many of the detailed provisions included within the rough classification above, my own conviction is that the presence of many of them in the law was absolutely essential, and that administration would have been much more difficult, perhaps impossible, if they had been left out. This is certainly true of the provision for consolidated returns, mentioned by Mr. Eyerly. Nobody disputes that that is an exceedingly difficult subject. It leads to very hard questions. But it is absolutely necessary in order to get reasonable and sensible results.

The same is true of "special relief" provisions dealing with abnormal cases in which, instead of a technical calculation of the excess profits tax, resort is permitted to a determination of the tax by comparison with rates paid by normal corporations in similar businesses.

There are undoubtedly spots in the earlier law which, in the light of experience, can be avoided by special provisions in the new law. Some excellent work has been done by the Subcommittee in that direction,--for instance, borrowed money, not allowed in invested capital before, is proposed to be allowed, subject to limitations. This is good, but it ought, I think, to be allowed without limitations, and its inclusion in invested capital should be at the option of the taxpayer.

It is, nevertheless, clear that there will be a very large number of cases in which abnormalities of income and invested capital, either with regard to the base period years or these test years, will produce fantastic and really unintended results under the technical provisions of the law. It is impossible, as I have said, for any draftsman to foresee even a small proportion of the abnormal incidences of such a law; that there would be plenty of them if a law were enacted in accordance with this Subcommittee report is evident from a first reading of it. It is not true that the principal troubles have been avoided by new express provisions.

No one who has watched tax administration in this country can fail to see how different the practical administrative problem is when the rates really get high. Problems of fact and law which were theoretically inherent in the situation, but could be treated by both sides as negligible under lower rates, suddenly become matters almost of life and death to the taxpayer, and there is a rapid multiplication of the number of points at which controversy is even likely to occur.
When the rate was two per cent for 1916, for instance, the problem of ascertaining taxable net income was treated by both parties as simple; each one could afford to ignore a large number of possible points of dispute. When the rates for 1918, only two years later, ran up to a possible 80 per cent, the practical problem of reaching an equilibrium between Government interest and taxpayer interest with regard to a particular taxable year on the very same actual facts, because a wholly different one, with every possible question active and controversial. If in fact the taxpayer is treated as having an income of $1,000,000, when actually, if every real element were considered, the business earned only $100,000, the levying of a high-rate tax cuts into the business' capital, with acute danger that the business will be ruined. Under a low-rate tax error or injustice in calculating income usually means merely that the proprietors will lose some of their earnings. Under a high-rate tax the risk is that they will lose part or all of the business itself.

Conscripting the use of capital is one thing and destroying the capital itself through the operation of the tax law is quite another. Specific examples would be the case where net income is overstated because adequate deductions for depreciation, amortization or obsolescence are not allowable under the law or are not allowed by the authorities, or where, due to technical inventory rules or other causes, income is assigned to a year to which it does not in substance belong.

The difference in administrative effect between low-rate taxes and high-rate taxes must be borne in mind, because otherwise it is easy to fall into the error of assuming that the long-drawn-out controversies occur merely because taxpayers and Government officials are litigious and love to fight. The real fact is that taxpayers in general do not want to fight, but are forced to do so in order to save not merely earnings but backlog capital; on the Government's side the necessary freedom of judgment of the officer who is charged with dealing finally with the problems is suddenly hampered by the knowledge that the larger the sums involved, the more dangerous his own position is if he deals with them boldly, risking almost inevitable criticism.

"Special Relief"

Not to provide such a statutory method as special relief, by which the Department can administratively reach a result which the taxpayer can afford to accept, would be against the Government's interest as well as against that
of the taxpayer, because, as stated above, the most important part of tax administra-
tion is the task of collecting the money for each taxable year promptly and with a minimum of controversy; and because, further, the successful adminis-
tration of the tax laws depends upon maintaining public confidence in the good sense of the laws and the good sense of those who administer them.

The "special relief" provisions outlined on pages 8 and 9 of the Sub-
committee's report dated August 8, 1940, amount to nothing substantial in their present form, and would give no real help either to Government or to taxpayer. They do not purport to give relief for abnormalities, either of income or of capital, and the so-called relief itself consists only of basing invested capital on wholly technical book values. Thus it denies relief at the precise point where relief will be essential. The assumption that genuine special relief is not called for because some of the situations formerly calling for special relief have been eliminated, is not sound. To be useful the special relief provision in the new law must be at least as broad as the provisions on this subject in the 1921 law were.

Consolidated Returns

With reference to the necessity of consolidated returns, you will recall that the actual experience of the Bureau in administering the 1917 law, which contained no such provision, constrained the Bureau, of its own motion and without legislation, to permit consolidation, because the administration of the law without it seemed impossible. Not until the 1921 law was this daring but absolutely necessary administrative action ratified by Congress. An obvious and vital defect of the Subcommittee plan is that so far no provision is made for consolidated returns.

Retroactive Effect

The retroactive action of the old war tax acts was a prolific source of the kind of acute hardship which makes taxes hard to pay and hard to settle. If the new act, as proposed, is retroactive to January 1, 1940, the same result will follow.

Direct Handling of High-Rate-Tax Disputes in Washington

Difficulties in administering the law under the old excess profits tax laws were in my judgment lessened by the fact that hearings and settlements in important cases for the most part occurred in Washington. Having in mind
again the distinction between the Bureau's function as a mere determiner of taxes
and its function as a conciliator and final settler of taxes,—the latter being
the more difficult and the more important,—my experience with Government
bureaus leads me to think that the exercise of the latter function under a very
high-rate tax can be effectively accomplished only at headquarters, and that the
Government suffers if it is not so exercised. It is inevitable that even an
able and courageous Government subordinate in the field, in taking the responsi-
bility of settling an issue running into millions, must to some extent be in
doubt as to what his superiors in Washington would do about the case if they
knew as much about it as he does. It is impossible for him to convey the whole
picture by telephone or even by a memorandum which his superiors will have time
to read, and the result is that the Government is at a disadvantage in the
negotiations, in that its direct representative cannot really follow his own
judgment,—however definitely he may have been instructed to do so. It is a
fact that absolutely independent action by a subordinate who is charged with the
disposition of cases is likely to arouse criticism in Congress and elsewhere
which endangers his job even if such criticism is unjust. The result is that
the only way to get genuine independent action is to have it occur in Washington,
where the Government's active representative is in daily touch with the real
policy-makers.

Personal Service Corporations

As one of the classes of cases presenting especial administrative
difficulties, I have mentioned the personal service corporations. This class
includes most insurance agencies, large and small, companies furnishing advice
of an engineering, accounting, or other technical nature, advertising agencies,
and most private schools. The income of such companies does not principally
come from the investment of capital, and for that reason no sensible result
can be produced by a method of determining an excess-profits tax rate based
on investment. Those companies within the classification were exempted from
the old excess profits taxes, with a proviso that, distributed or undistributed,
their profits must be reported by the stockholders. Serious questions of
policy arose in the case of the borderline businesses, until it could be de-
termined whether the company was a taxpayer under the law or not.

Some capital is used, of course, in any sizable business of this
kind, and for a long period vast confusion existed in the Bureau in determining
on which side of the line each of a large group of corporations came. A special section set up for the purpose of adjudicating these problems gradually disposed of a vast mass of medium-sized cases and a reasonable number of big ones.

I see in the Subcommittee's report that no corporation is to be treated as a personal service corporation unless its income is principally due to the active services of the principal owners or stockholders. Such a limitation is sure to cause trouble, because the technical provisions regarding invested capital are quite as inapt when applied to a business whose earnings do not mainly depend on the employment of capital, whether or not the services are due to employed executives as distinguished from stockholders. Further, the other excess profits tax option, depending on earnings during a "base period", is wholly unfair as a test of the tax rate in many businesses, especially in growing businesses, and is not available at all to businesses not in existence on January 1, 1936. I am in doubt, also, as to what the application of the proposed provision would be to a selling subsidiary (or other service subsidiary) of a manufacturing corporation. Can it be that the subsidiary, having no capital, is intended to be penalized on that account by having no option except to have its tax based on its income experience for the base period? If so, what is intended if the selling subsidiary was organized after January 1, 1936, so that under the new plan it has not even that option?

You will see that my own experience has convinced me that tax disputes should as a matter of government policy be kept out of the courts except in absolutely necessary instances, and, further, that corporate taxpayers are ready to cooperate with wisely planned efforts of the Government to carry out that policy. But the new tax bill, to be workable and productive, must first of all be able to stand some reasonable tests of its general good sense, and even if these tests are in some degree met, ought to include provisions designed to eliminate foreseeable hardships, and ought also to be so drafted that its provisions will afford the Commissioner full opportunity to settle cases by negotiation when unforeseeable hardships appear—such opportunity, for instance, would be afforded by true special relief provisions.

Thank you. (Applause)

CHAIRMAN ALVORD: Thank you very much, Bob.

You will recall that earlier in the day I stated that the demand by the Government officials for the immediate enactment of an excess profits tax
was so that persons who were about to execute contracts with the Government would have certainty as to their tax liabilities.

Mr. Miller has told you that we must first have certainty in the statute; second, we must have reasonable certainty in its administration. Now, your administrative officials have several functions. They have a legislative function, in which they sit exactly as members of Congress would sit and determine upon policies which, when written into regulations, will be law. Second, they have interpretative functions. They say, "We shall interpret the law this way," and they say that to everybody. Third, they have the job of applying the law and their regulations to the specific case. If there is ever an instance when the adjournment of politics is essential, it is in the administration of an excess profits tax.

The basic problem from the point of view of the Congress is always this: How can we adjust the problems before us so that we prevent unintended, unforeseen consequences, and at the same time give adequate power to the administrative official?

The balancing of those two problems is always a very delicate matter.

Mr. Miller has told you, and I concur, that the present proposal does not by any means eliminate the insuperable administrative problems of the prior laws, nor does it avoid new administrative problems.

This meeting is called for two reciprocal purposes. You gentlemen are asked to educate us. We are asked to give you some ideas. One purpose is to get down to a real basis for discussion. I thought that I kindled a fire. In any event, I attempted to. I like to build fires. And I now, even at the risk of postponing lunch, am going to give Professor Buehler an opportunity to heap condemnation, if he wishes, upon me. I am accustomed to it and I can take it. He asks for two minutes in which to answer some of the questions, or at least to propose other questions perhaps with respect to the questions that I propounded upon the conclusion of his address.

DR. BUEHLER: Mr. Alvord, I am not "hot" about anything, and I think your cool suit will keep me from getting warmed up.

CHAIRMAN ALVORD: Including the name that goes with it?

DR. BUEHLER: Mr. Alvord raised two questions that probably were suggested by my somewhat philosophical analysis of different arguments and points pro and con. One was whether the purpose of the tax ought to be to raise revenue or to regulate? Should the tax be designed to encroach on normal profits?
Well, I would say I do not know what the purpose is at Washington, but the tax should not, from a revenue standpoint, kill the geese, the taxpayers, who lay the golden eggs, the taxes. What I am trying to say is that if this tax is considered, it should be considered primarily as a revenue measure. Every tax regulates something; every tax has effects. A government cannot raise one penny of revenue with any tax without affecting something. And if there are incidental effects upon profits and business enterprise, they will have to be considered, too.

I agree that without the business man, the enterpriser, there can be no business. I did not wish to imply that capital was alive and vital without the business man. I am reminded here, however, of the talk I had once with a farmer. He was convinced that the farmer was the foundation of our economic organization. He said, "Without the farmer, you could not have any wheat or any raw cotton. He is the most important man in industry." Well, without capital, we could not have corporations, nor could we without the workers. And as for the enterpriser, he is the spark, the organizer. That has to be kept in mind in our taxation.

Now, on the other question, about the basis of an excess profits tax—should it be capital investment or something else? I suggested that if we taxed all income with a personal income tax, if there were no corporations, we would not need an excess profits tax; that is, the graduated personal income tax would take care of the profits derived, because the person with the larger income would pay the higher tax.

Now, it might be in some cases that the tax based on the total income of the period, rather than the rate, would be preferable. If a business or professional man is unincorporated, he pays no corporation income tax; but they get him on the personal income tax. And if it is a broker or some business executive of a small concern where the capital is incidental—let us follow it through—there is not much capital reinvested in our picture, because the money is made from the brains of the business man. Then the money is taken out of the business and it should be, I would think, taxed as distributed income. If the capital is unimportant and the money goes out, it ought to be taxed as income in the hands of the owner of the business. If it is, he pays his tax.

Of course, it is true that if the profits are undistributed, then there is another question. My idea would be that if we did not have the corporation income tax, there would not be any point in discussing an excess
profits tax. If we did not have to tax the corporation, I would not see any point in an excess profits tax. I would simply go ahead with the personal income tax and impose it at graduated rates.

CHAIRMAN ALVORD: Now, gentlemen, to facilitate preparation for discussion, we are going to give you an hour and fifteen minutes within which to build your fires. I will build a few up here, but I want you gentlemen to build fires there, both internal and external. I am interested primarily in the external fires. So use the luncheon period as well as you can.

We are here only for today. There are on the program the names of five discussion leaders. In the course of the luncheon hour, get together with them. They are Henry Fernald, Mr. Haberman, Mr. Houston, Ros Magill, and Mr. O'Daniel. Give them your ideas, so that in the discussion they can lead and attempt to perform the reciprocal purpose for which we are here.

I am very happy now to give you a chance to have lunch. Thank you very much. We will reassemble at two o'clock.

... The meeting adjourned at 12:45 for luncheon ...
The Conference reconvened at 2:00 p.m., Chairman Alvord presiding.

CHAIRMAN ALVORD: We will reconvene.

In the course of the afternoon discussion, I trust that everyone here will concentrate on one problem: How can we make the pending proposal better? That is a fairly large problem, one which will require concentration.

In framing the program, we designed the morning program for a general outline of the problems involved in an excess profits tax proposal, and the afternoon program for the general problems involved in this question of amortization. Primarily because the underlying problems are not tax problems, the morning session was led off by Mr. Brown, whose biggest qualification for leading off was his confession that he knew nothing about taxes. The afternoon session will be led off by a gentleman who claims to be even better qualified than Mr. Brown in that respect.

I am honestly of the opinion that the problems we are discussing are only secondarily tax problems. Therefore, I am confident that we are all very happy indeed to hear from Mr. Philip D. Reed on "Industry's Responsibility and the National Defense Program." Mr. Reed. (Applause)

Mr. Philip D. Reed (Chairman of the Board, General Electric Company):

Mr. Alvord, Gentlemen: This morning Mr. Brown posed so admirably for you the immediate bottlenecks and the log-jams in the great joint venture of government, labor and industrial management, that I shall say no more on that subject than to express hearty accord with the views he so ably expressed.

This democratic process of ours is, and I suspect always will be, a slow one. In the long run, perhaps, this deliberateness is not without elements of value, although in situations like the present, when we are so clear in our own minds as to what the right course is, we naturally become impatient and sometimes irritated at the delay.

I believe that the need for prompt action particularly on the amortization portion of the proposed bill, is recognized by Congressional leaders, and I believe too that the bill will become law in the near future. Then, gentlemen, we shall be off on a stirring race to enlarge, to synchronize, and to bring up to full speed the greatest production machine the world has ever known. The task that lies ahead for industry is more than just a big job to be done, more than a great responsibility to be well and efficiently discharged. It is also a magnificent and a much needed opportunity to demonstrate...
to the people of this country that one of the greatest and most precious assets of America is the enterprise system.

Without wishing to be an alarmist, I sincerely believe that we are now close to the threshold which separates and distinguishes our traditional way of life from the beginnings of those regimented, centrally planned and operated economies which are now so prevalent beyond our borders. Having crossed that threshold, there is no turning back. And we can cross it, gentlemen, without realizing until later that we have done so. A plant does not die instantly when its supply of moisture and sun are gradually reduced, but when the deprivation reaches a certain point the plant is as good as dead, though its leaves may not yet have turned brown.

And so it is with the enterprise system. It must have reasonable incentive and reasonable freedom of action if it is to live. At what point government-imposed limitations and restrictions on incentive and freedom of action will gradually but inevitably destroy the system, no one can definitely say, but that it has already been seriously weakened is, I think, evident to all.

And do I say that this defense program may well provide industry with a final opportunity to demonstrate again, and to many of our younger voters for the first time, the incomparable vitality, efficiency, and national worth of the enterprise system. Let us all bear this in mind as we move forward with the program. Let us remember that we must be statesmen, educators, and Americans, as well as business executives, and let us act accordingly in our relations with government and with the general public.

A few weeks ago I gave a talk before the Sales Executives Club of New York, which, for want of a better title, I called "An American Primer." Because the subject was closely akin to the one we are discussing here and because Mr. Brown has asked me to repeat a portion of it, I shall, with your permission, restate certain of the thoughts I expressed at that time.

We are told that the average American has received no more than a seventh grade schooling. It is clear, therefore, that the ordinary citizen cannot be expected to understand or to pass intelligent judgment upon the complex questions which are ever before us in business, banking, agriculture, government, and many other fields. But it is he, nevertheless, who will determine whether and to what extent America will continue to live by the principles so firmly established by our forefathers.
What can we do to keep these simple and fundamental doctrines ever before us? No one knows better than I the difficulty of keeping even reasonably well informed on the major problems of the day, and the hours of reading and study it takes to satisfy not a New England but merely a Midwestern conscience that one's views and pronouncements on current questions are not simply parroted from his favorite columnist, but are bottomed by careful thought and honest conviction. And because our Government must be active in so many fields and because the legislative and administrative questions before it are so diverse and numerous, it is most difficult to preserve perspective, to see the forest despite the trees, and to maintain an objective and consistent viewpoint. The task of thinking simply, unemotionally and directly, has perhaps never been more difficult and surely never more urgently needed than in this forty-first year of the twentieth century.

Formulæ for thinking, like rules for making friends and influencing people, must be open to the charge of over-simplification, and must prove to some extent ineffective. Nevertheless, in this disturbed and complex day in which we live, when in foreign lands outlaws and iconoclasts seem successfully to be defying the validity of the virtues we have always embraced; when character and integrity appear almost to inhibit rather than to help one's cause, it may not be unprofitable for each of us to sit down quietly and restate to ourselves as simply and briefly as we can the fundamental principles which made and, if we hold firmly to them, which will preserve our American way of life. Were we each to do this, the enumerations would doubtless differ both in number of items and in the order of importance of the common ones. The central core, however, would surely be the same.

If from that core we could formulate a simple one-page statement, a primer, if you like, of the doctrines of American self-government, and if we could spread that statement far and wide across the land for every American to read and live by, the present trends toward government by men rather than by laws, toward enlargement and centralization of government functions, and toward government by small but articulate pressure groups, would be arrested in their tracks. And were I asked to set down in brief and simple fashion the items I would include in a primer of American self-government, they would be these seven.

Our American Constitution is of inestimable value. In clear language it safeguards the fundamental rights of the individual. It limits the powers of government to those expressly and by clear implication given to it. Because
amendment is difficult and time-consuming, it stands as a bulwark against hurried, ill-considered, or emotional changes. The first item in my primer of American self-government is, therefore: Understand, honor, and preserve the Constitution of the United States.

American government, whether national, state, or local, comprises three branches which, in order to prevent concentration of power, must always be kept separate and distinct. They are the legislative branch, whose duty it is to enact all laws, subject only to the principles and limitations laid down by the Constitution; the executive branch, whose duty it is to administer but never to make the laws of the land, and to operate all government services; and the judicial branch, whose duty it is to interpret the laws made by the legislature to decide whether they conform to the Constitution, and whether acts or omissions of the people or of other departments of government are in accordance with the law.

The second item in my primer is, therefore: Keep forever separate and distinct the legislative, executive, and judicial functions of government.

Government is created by and belongs to the people. It has no rights or powers except as the people grant them. The cost of government must be paid for by the people through taxation, and the tendency is for government to grow and become increasingly costly. Because government is not like private enterprise, in which competition and the profit motive provide a tremendous incentive to careful planning and efficient operation, government is inherently less efficient than private business. Therefore, it should be permitted to do only those things which government alone can properly do, and which are necessary for the welfare of the people.

Thus, the third item of my primer becomes: Remember that government belongs to the people, is inherently inefficient, and that its activities should be limited to those which government alone can perform.

Of the many rights and guarantees which Americans enjoy under the Federal and State Constitutions, perhaps the most important are freedom of speech, freedom of worship according to one's own conscience, and freedom of decision and action in such matters as where to live, what kind of work to engage in, whom to work for, and at what pay. This freedom of action, coupled with the right of the American citizen to have and to hold the fruits of his labor, and to save or dispose of them as he wishes, is called the enterprise system, and it provides opportunity and incentive to improve one's position in life.
Our fourth item, accordingly, is: Be vigilant for freedom of speech, freedom of worship, and freedom of action.

The enterprise system under which thousands of private businesses and millions of men and women are constantly searching for new, better, and more useful products and services, and for ways to improve and lower the cost of existing ones, has produced a standard of living in this country higher than any which the world has ever known. The enterprise system cannot function successfully without incentive to improve, expand, and to create new enterprises. Accordingly, if the profits of business are taxed inordinately or if restraints and limitations are imposed which deprive the managers of reasonable freedom of action, or if government competes or threatens to compete with private business, the enterprise system will languish. These things should, therefore, be avoided, and if they are the inherent incentives of the system will cause business to expand, to create new enterprises, and profitably to produce ever better, over cheaper goods for more people to buy. Along this road lies progress and the only permanent solution of our unemployment problem.

The fifth item is, therefore: Cherish the system of free enterprise which made America great.

Thrift and economy are still the great virtues they were in our grandmothers' time. Debt burdens the future, and too much of it impairs one's credit. Borrowing, therefore, should be resorted to only in periods of real emergency. These principles apply equally to government and to private citizens. The difficulty is that government can borrow more readily than the citizen and, having borrowed for the benefit of one group, it is very difficult not to do so for other organized groups. Our national debt has risen enormously in the past ten years despite substantial increases in taxation. All this money must some day be repaid out of future taxes. Our immediate problem is to stop piling up more debt. This is not easy; indeed, for the moment it is impossible. The safeguard we must seek is widespread understanding of the problem, plus realistic and courageous leadership.

Briefly stated, our sixth item becomes: Respect thrift and economy and beware of debt.

Integrity of contract and respect for the rights of others are foundation stones of civilization. They have been all but destroyed in many quarters of the world, and until they are restored barbarism will stalk the earth. Let us keep the candle of integrity burning brightly in America. If we do so, we
shall one day use it to rekindle the flame of mutual trust, fair dealing, and respect for others in a suffering and chastened world.

The seventh and last item of our primer is, therefore: Above all let us be scrupulous in keeping our word and in respecting the rights of others.

This, then, is one primer of American self-government. If each of you would write your own, I am sure I would be satisfied to accept it, for it seems to me that the principles are so simple, so clear, that, having thought them through, we may say of them, in the language of our forefathers, "Those truths we hold to be self-evident."

But thinking on these subjects and, particularly, thinking through on them is not sufficiently widespread. Is it not our task as Americans to encourage and stimulate such thinking in every way at our command? For if our educators, our business and professional men, our churchmen and our farmers, our trade and civic organizations, would write their primers of American self-government and tell the story on a national scale through the press, the radio, the pulpit, the classroom, and the public forum, how could we fail to reinculcate in the minds of our one hundred thirty million home-loving citizens the rules for living the American way?

That, gentlemen, I submit to you, is a very real part of industry's task today and every day.

And now, in closing, let me say that I have deliberately avoided anything but passing reference to the wars abroad. Tragic and disastrous as they are for those involved and for ourselves, and essential as it is for us to view them realistically and to prepare for bitter times ahead, let us emphatically remember that these wars may obscure but they cannot and will not cure our domestic ills. Indeed, if on a peacetime basis we view dangerous tendencies toward the extension and concentration of government, toward the creation of too powerful bureaucracies, and toward unparalleled enlargement of our national debt, is it not clear that the preparation for or actual engagement in war must speed and aggravate those tendencies? Let us, therefore, keep our vision unclouded by emotionalism and let us recognize that conditions beyond our borders make ever more compelling the need for understanding, for teaching, and for living our primer of American self-government.

Thank you very much. (Applause)

CHAIRMAN ALVORD: Mr. Reed, if any one of us wondered why Lew Brown asked you to be on our program, I think the answer to that question has been given.
I am confident that I express the views of everyone in the room, that we now know the answer.

I might even take one step further and say that unless we are willing to accept and adopt and fight for the principles which Mr. Reed has just conveyed to you, then I might ask, "What in hell is all the fighting going to be about?"

We now get over into the second part of our tax program. We have heard it said that industry will not cooperate with the Government in the national defense program unless the problems of amortization are solved. I wish there were some other word than "amortization," because, whether it is by reason of the provisions in the prior laws or by reason of their administration or for some other reason, the word "amortization" seems to carry an inference at least of something special, some gratuity, some bonus, some unusual treatment.

There is considerable misunderstanding about amortization. Unless I am very, very wrong, amortization is not a tax problem at all. To me, amortization is merely a word which conveys some relatively simple business policies. Those simple business policies, to me, are:

1. Cost must be returned. I don't care whether you are buying and selling products or whether you are manufacturing and selling products; whether you are growing wheat or whether you are making flour; whether you are digging ore or selling steel; if you are going to stay in business very long, you must get your cost back.

2. There can be no profit until cost is recovered.

3. Cost must be recovered, so far as possible, from the proceeds of sale.

The tax laws, independent of the present emergency, recognize those principles. The depreciation allowance in the present law is based on the principle that cost of an asset should be recovered over its useful life, whatever the period of useful life may be. The emergency confronts us. The basic question is whether the emergency proclaimed by the President could properly be considered by the Treasury officials in determining the useful or economic life of a facility. If you are to get your costs back from a particular facility, you must get them back within either the life of the machine or within the period during which you are selling the product. Your machines become obsolete, the demand for your product ceases, and if you have not recovered your cost before either of these two things happens, you have been operating at a loss.

The emergency, to me, created no new problem in this respect. I think
the probable duration of the emergency is no more indeterminate or uncertain than the probable life of a machine that you gentlemen acquire today, which may be obsolete tomorrow. But the Treasury took the position that "a reasonable allowance for exhaustion, and wear and tear, including a reasonable allowance for obsolescence," did not permit them to take into consideration, in the administration of the Vinson-Trammell Act and of our ordinary tax laws, the proclaimed emergency. Consequently, there must be legislation. That legislation is incorporated in the tax bill that is now pending. It has no peculiar relation to an excess profits tax. There is no reason why it must be sandwiched in the center or included at either end of an excess profits tax.

The amortization provision is under active consideration. Assuming that there must be legislation, the Subcommittee report deals with the problem very fully, very fairly. As I read it, I can't help but believe some elements of confusion still remain. But Congress does have a very sound, sensible recommendation. Their solution of the problem, it seems to me, is eminently satisfactory.

If we are going to get cost back, problem number one is, what is cost? How are you going to get it back before somebody says you have income?

A simple case illustrates the principle, I think. If I buy this desk for ten dollars and sell it to Mr. Reed for fifteen dollars, I don't think there is a gentleman anywhere in the Treasury or out who would say that any part of that ten dollars was income. I think that the reason there is such certainty in that principle is merely that it is so easy to determine the cost.

Now I will turn you over to someone who knows something about more complicated problems in recovery of costs - Mr. Weiss, of Ernst & Ernst. (Applause)

MR. L. C. WEISS (Ernst & Ernst): Mr. Chairman and gentlemen: I think it is high time that the Chairman turned this subject over to someone else, because I don't believe we can agree with some of the things he said about amortization, - about the satisfaction of industry or of taxpayers with the proposals of the Sub-Committee. I think he has again thrown a little fuel on the fire.

Every week the United States Army Recruiting Service has a broadcast from the Military Academy at West Point. In this program they stress certain personal considerations: - steady employment, good food, comfortable living quarters, pleasant associations, educational advantages, compensation above all living expenses, opportunities for promotion, etc. (I notice by the Times this morning a proposal to increase the basic rate of army pay from $21 to $30. I think if
they would raise the amount to $35 or $40, they might get quite a few recruits from the public accounting profession and from industrial management faced with these defense problems.) But the point I want to emphasize is that each of these inducements urged in the recruiting of men concerns the welfare of the individual. Now, if this defense program of ours is to meet with the greatest success, it should give more consideration to the welfare of industry. Our proposed excess profits tax law is, of course, a part of the defense program.

The experiences of industry in the World War are still fresh in the minds of management -- the losses, the receiverships and bankruptcy which followed in the wake of that war. Naturally, management is now cautious, being careful not to enter into new arrangements and commitments until it knows what the consequences are going to be. We must avoid the mistakes of the past in the drafting of this defense program so as to restore industry, in so far as possible, to a condition as good at the close of the period as it was in before the emergency began.

The Vinson-Trammell Act has been generally recognized as a millstone on our defense program. The Defense Advisory Commission, I understand, has strongly urged the repeal or suspension of that law, and I think Congress is sympathetic with that objective, because it is proposing to substitute an excess profits tax under which the profits of industry can be controlled.

It is not my belief that industry looks with special favor upon these Government contracts. They are in many respects not particularly desirable business. They disrupt normal commercial business and upset the general scheme of things, -- particularly a program that requires plant expansion beyond that required in normal times. Certainly this feeling on the part of management is not a reflection upon its patriotism. It merely reflects justifiable caution as a result of its experiences during the World War.

Industry, I am sure, is willing and eager to take part in this defense program, but it wants to know what the rules of the game are going to be. After all, management is only the trustee of the properties of its shareholders, and by what right can trustees subject these businesses and properties to unnecessary risks even in a time of national emergency? Merely to have informal instructions from the Government to "go ahead and you will be taken care of" is a rather unsatisfactory way to have management undertake large commitments that involve properties belonging to other people.

Now, let us suppose there is received a hundred thousand dollars from a
Government contract, and let us assume that eight thousand dollars has been estimated as a fair margin of profit. Let us also assume for purposes of my illustration that the taxpayer had spent twenty-five thousand dollars for new facilities and the cost of these facilities was reimbursed in the contract price. Unless the cost of these new facilities is also allowed as a deduction in the computation of the excess profits tax, it is very possible—and this certainly would be true with the rates that are now under consideration—that an actual loss might result from the contract. Instead of recognizing the true profit of eight thousand dollars from this contract, a much larger "taxable income" could result if an inadequate allowance for amortization is obtained and the resulting excess profits tax might be greater than the true profit from the contract. This is of such importance that industry must know before it undertakes commitments that adequate deductions for amortization will be allowed.

With respect to the recovery of usual costs, such as labor, material, and overhead, these things will, I assume, be taken care of in all contracts when they are made and my remarks will, therefore, relate principally to plant extensions, depreciation, inventory and losses. Of course, these items too should be taken into consideration in determining the contract price, as it is only in this way that direct reimbursement may be obtained, but that alone is not enough. Recognition should also be given to such items in any excess profits tax law so that such taxes will be based upon true income; otherwise, a tax upon statutory income may exceed true income and become a levy on capital itself.

In the development of this defense program, many manufacturers who now have plants which are adequate for normal commercial business, are going to be induced to enlarge those facilities for the temporary production of defense materials. When that emergency is over, these companies will be left with enlarged plants. Such facilities will not necessarily be obsolete; they may not be obsolete at all, but they will provide productive capacity in excess of the normal needs of business. What then is going to be the result? There will be local taxation, certainly, that will have to be paid for an indefinite period, as long as those facilities remain. There will be insurance and maintenance charges and carrying expenses, and very probably an increase in operating expenses caused by use of extended facilities with an inadequate volume of business. The business might be better off if it could be restored to the condition which existed before the expansion; it probably could operate more efficiently and at lower costs.

Undoubtedly, at the end of a period of this kind there will be a problem
of disposing of labor. You perhaps remember that at the close of the World War, the Government appealed to industry to keep labor employed as long as possible to gradually work out a period of readjustment. This adds to the expense of carrying business through a period of declining operations and is another of those loss items directly chargeable to the period of abnormal activity. Undoubtedly, the same thing will happen again.

If we follow the pattern of the World War period, many companies will exercise options to acquire facilities that have been financed and erected by the Government. You might ask, "Well, if those companies do not need the facilities, why should they buy them?" Often the purchase of such facilities is necessary to protect commercial business, whatever it might be. Not to do so would in many cases bring new competition, perhaps at lower costs because of the low prices and easy terms at which surplus facilities can be purchased. In any event, the use of such excess facilities in increased production would cause a spread of normal business, - the same normal commercial business which for many years past has not been adequate to take care of plants as they existed before the contemplated expansion has taken place. Of course, the surplus plants could be destroyed, but experience has shown that industry is loath to "plow under" the excess facilities, and so they are continued with the economic losses and the demoralization of business to which I have referred.

The machine tool industry, we well remember was running to capacity during the World War and we all know that after the War it had long years of inactivity and losses. Now, again, this industry is operating at capacity, but no one can doubt that when this emergency is over, the machine tool industry will have a long period of inactivity and losses. The markets of the country will be flooded with second-hand machine tools and there will probably be an absence of foreign markets for those products - a very serious prospect in that industry. Here, again, I refer to post war losses which will have to be fed by the profits of the preceding period of abnormal activity. The thing we must guard against is the shortsighted view that the profits resulting from the period of increased activity are "excess profits" and against public interest so as to justify a high excess profits tax. The public often does not understand and our legislators fail to recognize that every period of this kind is followed by a period of business recession with large losses which are inevitable and must be anticipated and provided for during the years of profitable operation. Our tax laws should safeguard industry by recognizing this situation.

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I should like also to refer to the aircraft industry, a great industry that is still in its infancy. We cannot overemphasize its importance in the commercial development of this country as well as its essential nature in our program for national defense. This is a field in which the expansion of plant facilities will probably be greater than any other, and it is essential that measures be adopted to insure the protection of this industry, so that it will be strong financially and can carry on unimpaired when this defense period is terminated. There is great danger of crippling this particular industry because of its rapid growth and the expansion which will be necessary under the defense program.

I have noted that the six largest manufacturers in the aircraft industry in the United States had a sales volume in 1936 of sixty-two million dollars. The same companies had a volume of two hundred fifteen million in 1939. Net profits of these six companies were four million seven in 1936 and thirty-one million eight in 1939. One of the interesting things about the financial condition of this industry at the close of 1939 was that these six largest manufacturers were using as working capital one hundred million dollars representing advances on contracts; so they were carrying on their operations largely on borrowed capital. I mention this because of the real problem of raising large amounts of capital for the extension of plant facilities.

The Sub-Committee of the Ways and Means Committee, as we heard this morning, has made certain recommendations in connection with the subject of amortization, although I believe, in fairness to industry, and certainly to speed up the defense program, those recommendations should have been more liberal. Incidentally, the New York Times this morning indicated that probably this amortization provision might be given separate consideration and perhaps enacted into law before the excess profits tax is passed. Our Chairman has referred to the weeks of consideration which should be given to the drafting of an excess profits tax bill. This subject of amortization can probably be taken care of in much shorter time and, Congress may recognize the advisability of disposing of it in advance of the excess profits tax itself.

In reviewing the recommendations of the Sub-Committee, one of the first things to determine is the particular facilities to be amortized. The recommendation is that items of land, buildings, machinery, and equipment, or parts thereof, constructed, reconstructed, erected, installed, or acquired after July 10, 1940, be included. Passing for the moment the date of "July 10," this is, whether it
should be this or some other date, I should say the question might well arise of whether a binding contract entered into prior to July 10 would represent an "acquisition" so as to preclude amortization of expenditures under the contract if made after that date. The Committee recommends specifically that any contracts entered into prior to the end of the emergency period shall be fully included as an "acquisition" even though the installation may come some time subsequent to the close of the period.

The Sub-Committee also proposes that only those facilities shall be amortized which are certified by the Defense Advisory Commission and either the Secretary of the Navy or the Secretary of War. They must certify that these facilities are necessary in the interests of national defense during the present emergency. This may be too restrictive. For instance, there will be companies dealing directly with the Government; obviously, they will be covered by the procedure recommended; but there will be subcontractors who will have no direct connection with the Defense Commission or the War and Navy Departments. The question is whether they, too, may go to these Government agencies to establish their claims that the improvements are essential. There will also be the ordinary suppliers who may have no direct Government contracts or even subcontracts, but whose facilities may be considerably expanded to furnish materials that will go into production for defense purposes. Certainly, the amortization provisions should be broad enough to include all of these.

Under the old law as it existed during the World War, an allowance was made in the case of "facilities acquired for the production of articles contributing to the prosecution of the war." This provision was very broad, - it did not require approval by anybody. It was only necessary that the facilities be "used" in the production of materials contributing to the prosecution of the war. I think we should now have a provision as broad as that, in fairness to industry, and it should cover "facilities acquired in the interests of national defense during the present emergency." I do not believe our legislation should produce inequity, - deprive anyone of the privilege of recovering the cost of facilities incurred for defense purposes.

When does the period start? The Sub-Committee recommends that facilities acquired after July 10, 1940 be amortizable because that is the date on which the President asked Congress to enact an excess profits tax and to make provision for amortization. I understand the Defense Commission originally contemplated using the date January 1, 1940, believing that was a convenient date.
and marked the beginning of a calendar year. After considering the matter further, I believe the Commission recommended the date of September 8, 1939 be used, that being the date upon which the President proclaimed this temporary national emergency. Many companies since this proclamation on September 8, 1939 have expanded their facilities. It seems somewhat harsh to me, if the purpose of that expansion was to produce defense materials, that such companies should be denied the right to amortize plant purchases made prior to July 10, 1940. By what logic can such a position be justified? Incidentally, under the Vinson-Trammell Act, the Treasury Department has ruled that interest may be included as an element of cost on and after September 8, 1939, thus recognizing this date very definitely for that purpose.

In using the September 8, 1939 date, it would not necessarily follow that 1939 income tax returns would be affected. Amortization could be allowed with respect to facilities acquired after that date and the deductions for income and excess profits tax purposes might well start January 1, 1940, or any fiscal year beginning after that date.

With respect to the period of charge-off, the Sub-Committee's report recommends five years, with a provision for reallocation or redistribution if the emergency period is ended within that time. The Defense Commission originally thought a four-year period would be fair to industry. In either case, an option was given the taxpayer to continue the period beyond four or five years, thus making his charge-off over a longer period of time. In both cases, provision was to be made for redistribution of costs if the contract was cancelled before the termination of the emergency period. I think that might well apply where contracts are completed within the period and not renewed. In other words, a manufacturer might be induced by the Government to enlarge his facilities for the production of defense materials, and not have a renewal of that business. It seems to me under such conditions that the cost of those facilities might well be amortized over the period of the contract.

In the suggestion of the Defense Commission with respect to amortization allowances, I understand it was provided that a taxpayer could elect not to take the full allowance on a ratable basis in the first year or second year; in the year that the facilities were acquired, he might not have any income from the use of the new facilities. It was thought that he should be permitted to defer the charge until the succeeding year. In other words, if amortization were figured on a four year period, the taxpayer might take ten per cent the
first year, forty per cent the second year, etc. He could not exceed the accumulated total at any time, that is up to twenty-five per cent in the first year, fifty at the end of the second year, etc., but he could defer in one year and make up the deficiency in the succeeding year or years. That seems a very equitable provision, in order that the costs may be applied against the income during the same period.

I think the use of a fixed amortization period, if it is reasonable, is desirable. You will remember under our old laws this was very indefinite. A fixed period would simplify very much the determination of these allowances. There would be less argument with revenue agents and less delay in determining tax liability. In any event, the rights of the taxpayer should be clear, so he will know how his taxes are to be computed, and will not have to wait for years after the period is ended to know what his tax liability will be. You may recall that during the World War, when the law provided for a "reasonable allowance" for amortization of war facilities, it required many years to close amortization cases. The determination of a "reasonable allowance" involves the exercise of judgment on the part of somebody, and the Treasury was severely criticized, as you may recall, by a Congressional Committee for the allowances that it made in certain cases, - and I do not wish to imply that those allowances were not made in good faith.

I do not believe in the computation of amortization there should be any allowance for salvage values. The Sub-Committee in its recommendations apparently does not contemplate such an allowance. Under the law in effect during the World War, it was necessary to compute value-in-use of facilities in the post-war period. This involved many questions. A value determined in the light of conditions on the date of valuation, might look all right, but the picture could be very much changed within a short period of time. The facilities that are left - bricks and mortar or excess machinery and equipment - might have some value; but, as I said a few minutes ago, excess facilities often represent a liability to the company that owns them, - a liability to pay increased carrying charges and expenses of maintenance. In many cases it would be better if those facilities did not exist at all.

Now, with respect to depreciation, - undoubtedly most of you have had controversies with representatives of the Treasury Department relative to depreciation. It seems to be a field for constant adjustment and involves a great deal of expenses, many arguments, and a lot of delay. Companies which today are
conducting a commercial business may, instead of expanding their facilities, operate double and triple shifts in order to contribute to this defense program. I fear that to leave the allowance for depreciation as it is in the present law - "a reasonable allowance" - will perhaps not work out as equitably as it should to industry. The use of unskilled labor, which will probably be quite a factor with the stepping up of this defense program, and the increasing hours of operation of machinery, require that consideration be given to abnormal depreciation and Congress should make provision for this condition. This loss is as real to taxpayers who use their facilities under abnormal conditions as it is to other taxpayers who acquire new facilities.

Another subject which does not seem to have been dealt with at all in present recommendations, is that of inventories. In the carrying out of this defense program, it is inconceivable that there will not be a large increase in inventories of materials of all kinds, and when the emergency period is over and we have surplus stocks of these materials, it is inconceivable that there will not be a tremendous shrinkage in the value of such materials. When is that loss going to be taken as a tax deduction? Is it going to be taken in a period when industry has no profit and after the profits of the defense period have passed? Will there be no tax credit for the substantial inventory losses that inevitably follow periods of abnormal activity? You may remember that in 1921 - not at the close of the World War, but in 1921 - we had tremendous shrinkages in inventories. Corporations had large losses, and at that time there was no provision permitting such losses to be thrown back against the income of the period responsible for the acquisition of those surplus inventories. Just to refresh your memory of that condition, let me point out the profits of 1920 against the losses of 1921 of a few of our large corporations. Proctor & Gamble in 1920 had a profit of four million; in 1921, a loss of fourteen million. United States Rubber, a profit in 1920 of ten million; a loss in 1921 of eighteen million. Atlantic Refining, a profit of ten million in 1920, a loss of almost four million in 1921. Sears Roebuck, a profit of eleven million in 1920, a loss of sixteen million in 1921. Armour & Company, a profit in 1920 of five million three, a loss in 1921 of thirty-one million seven. General Motors, a profit in 1920 of thirty-seven million, a loss in 1921 of thirty-eight million.

This is a condition that should receive serious consideration. It seems to me just as necessary for a redetermination of income of the emergency period to provide for inventory losses as it is to provide for a loss on plant
facilities acquired for defense purposes. Such losses are directly attributable to the unusual conditions which bring abnormal business activity and should be charged against the profits of that period.

I would like to mention, also, certain commodity prices of 1920-1921, just a few of the items to show you the substantial changes. In the case of wheat, the average price in 1920 was $2.44 a bushel; in 1921, $1.33. Sugar, a pound, 12.7 cents in 1920, down to 6.2 cents in 1921. Petroleum, $3.04 a barrel in 1920, down to $1.731 in 1921. Pig iron, $43.80 in 1920, down to $24.05 a ton in 1921. Cotton, from 33.9 cents a pound in 1920, down to 15.1 cents in 1921, more than a fifty per cent shrinkage. These are the things that are sure to follow this temporary emergency period and, I say, should be given serious consideration in the drafting of an intelligent tax law.

In conclusion, I want to say that in the formulation of policies and in the adoption of a defense program, we must keep clearly in mind and bring to the attention of our legislators experiences that industry had in the World War, and the fact that the laws then were inadequate to safeguard industry with respect to post-war losses arising wholly from the period of war activity. It is essential that we protect and preserve our great American industries. Our aim should be to restore industry at the end of this emergency period to as good condition as it was in at the time the period began.

Thank you. (Applause)

CHAIRMAN ALVORD: Thank you very much, Mr. Weiss. I assume that everyone here has begun to realize that not only may there be differences of opinion, but there are very real problems involved.

No amortization discussion, no amortization policy, could be complete without an appreciation of the administrative problems involved. Our next speaker was one of the investigators for the so-called Couzens Committee. He was then Chief of Staff of the Joint Committee on Internal Revenue Taxation, and about two years ago he resigned to practice law in Washington. He will discuss administrative problems under the old law as well as under the new proposals.

MR. L. H. PARKER (Former Chief of Staff, Joint Committee on Internal Revenue Taxation): Mr. Chairman, Gentlemen: I am going to do you a little favor. I am going to make my remarks concerning amortizations very short, because in my written statement I departed somewhat from administrative procedure and covered some of the matters already stated by Mr. Weiss and others. That will have two
advantages. It will not bore you gentlemen with matters which you have already listened to, and also will enable you to arrive sooner at the open discussion, which I am certain will be one of the most valuable parts of this meeting.

The Revenue Act of 1918 provided for the amortization of the cost of facilities necessary for the prosecution of the war. Amortization was a deduction from income resembling depreciation. The deduction affected both the income subject to the normal tax and the income subject to the excess profits tax. The purpose of the provision was, of course, to encourage private business to consummate contracts for war materials with the Government, and also to encourage industry at large to produce for war purposes.

I assume that most of you have a good recollection of the amortization provision contained in the Revenue Acts of 1918 and 1921. Therefore, I shall confine myself to mentioning some of the major administrative problems in administering this provision.

The first difficulty met with was to determine what facilities were subject to amortization. At first sight, they would appear to be those necessary for the prosecution of the war acquired between April 6, 1917, when war was declared, and November 11, 1918, when the Armistice was signed. However, the determination of what facilities were subject to amortization was not so simple as it appeared.

For example, I recall that a claim for amortization was submitted by a cleaner. He claimed that he had to put in additional facilities for cleaning soldiers' uniforms. Probably he did a lot of other cleaning work that was not for soldiers' uniforms. That led to controversy. There was controversy as to whether a manufacturer who made boxes that might be used for ordinary commercial purposes and which could also be used for packing articles to be shipped abroad, could amortize his added plant facilities.

The Treasury, as a matter of fact, gave some leeway on the November 11, 1918 date, and allowed facilities to be amortized which were acquired before December 31, 1918.

The total amount of amortization was reasonably certain when the facilities subject to amortization were discarded or sold within the war period. This was not the case when the facility was still retained by the taxpayer but not used to its full capacity. In case the facility was retained in use, the Bureau of Internal Revenue was under the necessity of determining the value in use. This was the most difficult problem in connection with amortization and led to a
great deal of controversy.

In most cases, the Bureau tried to determine the value in use by comparing the capacity of the facility with the average actual use made of the facility during the three years 1921 to 1923. It is obvious, therefore, that the final determination of the amortization allowance was not arrived at until many years after the Armistice of November 11, 1918.

A good many problems arose in determining the value in use. One question was whether you should measure the post-war use of a plant as a whole or whether you should go through a plant and determine the useful value of every individual item therein.

For example, a company might have built a machine shop for war purposes; after the war, if production went down, they used it, but certain lathes or certain other equipment in that shop might be used to full capacity and others might be used to only 10 per cent capacity. And, of course, when you came to a big amortization claim like the United States Steel Corporation's, of around fifty-five million dollars, with an enormous number of facilities, it became almost impossible to handle such a case facility by facility.

So that, while I was at that time, as Mr. Alvord has said, with the Couzens Committee, which was reputed to be in the business of criticizing, I think we all felt that the amortization provision was a perfectly fair provision and that the Bureau had done a fairly good job under difficult circumstances, although, of course, there were unusual cases which were deemed to be subject to just criticism.

The selection of the three years, 1921 to 1923, was, of course, entirely arbitrary. It developed subsequently, by 1926, that many of these facilities, which were only 50 per cent or 40 per cent in use during those years, were used during the good business period from 1926 to 1929, 100 per cent. But after all, keeping in our minds clearly that amortization is only accelerated depreciation, we know that if they got amortization in that period it meant that they could not subsequently get depreciation on the same amount.

The delay in settling tax cases involving amortization was very serious and was expensive to the Government. The interest on those claims for amortization which were not settled for a good many years, may have amounted, on the average, to somewhere between 33-1/3 per cent to 50 per cent of the amount of the claims. So that was an extra governmental cost brought about by the nature of the provision, which was administered so as to prevent a final determination until
years after the return was filed.

Among other questions were legal interpretations. There were no court decisions on amortization, I believe, until about 1923 or 1924, and subsequent to that date the decisions were not numerous.

It is probable that under the old interpretations a very great number of facilities were amortizable in connection with which no claim was filed.

Due to the language of the law, railroad companies and pipe lines were denied depreciation. That came about because the law contained the words "facilities, including vessels" and the courts held that because the language of the law said "including vessels," it meant to exclude other transportation facilities like railroads and pipe lines.

Now, on the other hand, I believe personally that, due to the war need for food, for instance, a farmer could have gotten depreciation on a plow. And it is very likely he could have benefited in a small way from amortization if he had claimed it. But he never claimed it so he got no benefit.

There were thousands and thousands of small taxpayers that could have reduced their taxes by amortization claims, but never claimed them. In spite of that, I think the total amount claimed during the World War ran somewhere around a billion dollars.

I shall not attempt to describe the various and intricate accounting problems which arose in determining the cost of amortizable facilities. But I will mention the fact that for at least five years the taxpayer was in the dark as to how to compute his amortization claim.

I was reliably informed at the time, that the Amortization Section of the Bureau, which was composed largely of engineers, were instructed not to tell the taxpayer how to make out his amortization claim. I never felt that the policy was very fair, though I understand how it grew up, because in the first several years the Bureau didn't know what policy to set up.

There is a provision for amortization in the proposed excess profits tax legislation, and this provision will affect not only the excess profits tax but also the normal tax, as was the case with the amortization provision of the old law. There are distinct advantages to the new proposal, because it has more certainty than the old provision.

In the case of the new proposal, the taxpayer will know that he can amortize most of the cost of that facility over a five-year period. In other words, it can be said that in the usual case a depreciation rate of 20 per cent
will be allowed. A taxpayer is also allowed several options on the spread of amortization. This will be helpful in avoiding disputes.

In order to secure the benefits of the amortization provision, the taxpayer must obtain a certification from either the Secretary of War or the Secretary of the Navy or the Advisory Commission of the Council of National Defense, that the acquisition or construction of a facility to be entitled to amortization is necessary in the interests of the national defense during the present emergency. In other words, under the proposal, the difficulty that I mentioned in the old law with regard to what facilities would be entitled to amortization, will be shifted from the Treasury Department to the War and Navy Departments and the Council for National Defense.

In issuing those certifications, which apparently is thought simple, it seems to me that those agencies of the Government will encounter a good deal of difficulty in determining what kinds of facilities they should certify. I think they will probably be more liberal than the Treasury Department would be, not having their eyes specifically on the tax receipts.

I do not anticipate that there will be great difficulty in amortization in those cases where we have direct contracts with the Government. Difficulties will arise in the case of subcontractors who must obtain the certifications referred to. And when we proceed beyond the first subcontractor to the sub-subcontractor or even to those taxpayers simply furnishing items on an order, a great deal of difficulty will arise, and, as in the case of the old provision, it is probable that a great many taxpayers who are entitled to amortization will not receive it, either because they don't understand it or because the amount involved is too small.

To illustrate that, here is a case I remember which came up under the old law, and it could come up just the same under this proposed bill. During the war an individual had bought a gasoline-propelled barge which he used to transport supplies from Philadelphia to Hog Island, a shipyard. Now, along in '26, a good while afterwards, he received a deficiency notice from the Government. They claimed he owed a couple hundred dollars tax. He had bought this barge in 1917 and had used it for a while in '18 and sold it in '18. He had taken off 20 per cent depreciation. The Government said, "No, you can only have 10 per cent," so that made a difference of about two hundred dollars in the tax.

He just happened to come in to see me, and asked me about it. I said, "You have got a clear claim for amortization here. You can take it all off in
one year."

I tried to explain to him about amortization. He couldn't understand that. He wrote the word down on a piece of paper. He had a conference set for himself with the Bureau. In fact, he told me he had to borrow the money to come down to Washington to attend this conference. He came down to the Bureau. He said if he could get his 20 per cent depreciation, that was all he wanted. The Bureau wouldn't give it to him. Then he said to the conferees, "Well, I'll have to hire a lawyer and put in an amortization claim."

They didn't let him get away. They said, "We'll give you the depreciation."

That shows you how some of these provisions are administered. The little fellow is going to have a lot of trouble. He isn't going to go down to Washington and get certifications because he bought a hundred dollar item to put in his workshop. Still, what he is producing may be necessary for the national defense.

As far as I can determine, such facilities as railroads and pipe lines are not excluded from the benefits of the proposed amortization provision, as was the case with this provision during the World War. However, the Association of American Railroads, according to its testimony at the hearings before the Ways & Means Committee, is in considerable doubt as to whether its members will be entitled to amortization.

Of course, we are very much hampered in considering details by not having any draft of the amortization provision and seeing what will be done about the salvage value, for instance, which is not clear to me from the Committee report. The original proposal, I think, was somewhat broader than what is contained in the bill. I think it was proposed to have a shorter period than five years—perhaps four—and also, instead of allowing a taxpayer a maximum of 20 per cent in any year, or 25 per cent, as the case might be, he could take, say 10% the first year and then he could take not over a total of 50 for the first two years, so he could take 40 per cent in the second year. That would have been, of course, much more beneficial to the taxpayer, because in the first year he hardly gets into operation, profitable operation, to a degree which would use up the 20 per cent of amortization now proposed. In the second year he could use more than 20 per cent, very likely.

In conclusion, I believe that the amortization provision is necessary under present conditions and will work out fairly well from an administrative
standpoint -- not perfectly so. I do think that it has great advantages over
the old provision, because there will be certainty and there will not be as much
delay in the final closing of tax returns which are computed on the basis of an
amortization allowance.

Thank you. (Applause)

CHAIRMAN ALVORD: Thank you, Mr. Parker. I know there is no one who
knows more about the problems of amortization under the prior law than you,
Mr. Parker.

He and I fought for years, and it may be that that constant fighting
is the basis for my great respect for him.

I suggest that when the provisions of the bill are available, you
analyze the bill very carefully from four points of view: First, this element
of return of cost, to which I referred. Second, no profit until you get your
cost back. Third, that your costs must be recovered out of the income realized
on the sale of the particular product. And fourth, a problem which has nothing
at all to do with amortization; where the proceeds of sale are inadequate to re-
pay cost, the problem of reimbursement or payment of cost without its being con-
sidered taxable income.

Those are your four problems, as I see the amortization situation.
Then make certain that you understand just how the proposed amortization provision
will be administered, so we can avoid the difficulties we ran into before, and
perhaps make it work more smoothly.

CHAIRMAN ALVORD: Now I am very happy to turn the meeting over for
closing to Mr. Brown.

MR. BROWN: Well, gentlemen, I am very happy that the Tax Foundation
had this opportunity to be able to bring these experts here so that you men
could listen to what they had to say on this subject and give you an opportunity
to discuss and clarify this problem.

I think that in closing we ought to thank Mr. Alvord as Chairman for
the splendid contribution he has made, and for his offer to stay here until mid-
night and talk with any of you men that are not already tired out with the meet-
ing and want to gather around this table in this room or any place and discuss
this subject further.

As for the action that can come out of this meeting, the Tax Foundation
cannot take action in the nature of organizing a committee or going down to Con-
gress to lobby. That is not our function.
If there is no other viewpoint of any of the members on the floor as to any other action we will take, I propose that we adjourn this meeting formally and make the room available for any of those that want to stay and talk with Mr. Alvord or any of these other experts. Is there any other view that anybody wants to express from the floor, contrary or otherwise to that program? If not, gentlemen, the meeting will stand adjourned formally, and for informal discussion if you wish to stay.

Thank you very much.

... The meeting adjourned at 5:20 p.m. ...