

The Economic Club of New York

67th Meeting

The Federal Income Tax

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Introduction

William Church Osborn

Gentlemen, I am very sorry to have to begin with an unfortunate announcement. Senator Copeland who was to be one of our star performers tonight sent Mr. Ely a telegram at 3:30 this afternoon saying that matters over which he had no control required his presence imperatively in Washington. I am very sorry because he would have been extremely interesting on the Income Tax, and I have no doubt that he would have told us what was going to happen in the matter of certain investigations which are proceeding there. Mr. Ely has an invitation to deliver to you gentlemen and I will ask him to deliver it to you in person. (Applause)

MR. ELY: Mr. President and Members of the Club, I believe that this is the first time in the history of the Economic Club that we have not had at least as many speakers, although they were not always the same ones, as were announced. I think it is the first time that we said there was going to be four speakers to discuss a subject and you came and found there are not but three, but, then, these three will make up on quality what may be lacking in numbers. (Laughter and Applause)

Now, on divers and sundry occasions you have heard some mention of a building known as the Town Hall with some intimations from which you drew your own conclusions. I have great pleasure in talking about the town Hall tonight for two or three minutes from a little different

point of view. This time we will ask you to do nothing except to give us the genuine pleasure of crossing our threshold and enjoying yourself.

On Friday there is to be presented to us a very beautiful organ. Mr. Speyer gives this organ to the Town Hall in memory of his wife who died about three years ago, and on Friday the formal presentation is to be made.

I am sorry to say, to our very deep regret, we cannot ask you to come in the morning because, to let you into an awful secret, we have already asked more people than the Hall will hold, but in the afternoon and evening there are to be organ recitals with some twelve or fourteen of the best known organists in New York, and we should be perfectly delighted if you happen to be in our neighborhood and would drip in for a little while, in the afternoon or in the evening from 8 to 10, or thereabouts, and from 2 o'clock on in the afternoon. Mr. Speyer's idea, and it is our idea too, is that that organ should be in a perfectly true sense the people's organ in a region not very celebrated for harmonious sounds -- the elevated is not so far away -- we like to have some things that do not suggest rattley-bang discords, but rather the more beautiful side of life, and to have it right here in this neighborhood, within a stone's throw of the busiest spot on god's earth. Well, we think that is rather a good place for harmony and bounty and peace, if you can get it.

Now, there is another invitation too. You have heard some talk about the Town Hall Club, and some of you have been kind enough to take the necessary steps to enjoy the advantages of that

Club. Well, the Club has begun to function in a rather simple and primitive way, but every day now from half past twelve to two o'clock lunch is served in the Club quarters just over the auditorium, and we would be delighted to have any of you come. There are no club limitations as yet, but up to the middle of April we go on in this simple way. The luncheon is \$1.00 and you come when you like and bring any of your friends with you, and you may drop your overcoat and hat anywhere you will without reading a sign "Not responsible for coats and hats not checked." We would be very happy indeed to have you come. The pleasantest thing about it all is not the building or any material thing at all, but it is the people and the kindness and friendliness, the public interest that have been shown. Well, I will tell you, they touch us down to the ground and I am looking right in the faces of a lot of men who have shown just that spirit, and when I say we thank you, I wish you would put into those words more that if possible they ever meant before. (Applause)

MR. OSBORN: I think that we are going through a revolution, a slow revolution, not political, but social and economic in its character. The taking over of the liquor business, or the destruction of the liquor business, was one of the invasions of the old rights of private property. The development of the surtax rates in the income tax system seems to me to be distinctly social and not economic in its character. The regulation of the railroads is distinctly social. We have gotten down to the point in our political life where there is a counter revolution going on, and we are revolting from the universal suffrage and the general revolt of the people of the United States into the bloc representation.

I don't think that is going to get very far. I do not think that there is likely to be very much in the way of a successful political revolution in this country while the various political elements have their opportunity of expressing themselves and of being represented. But we are undergoing a tremendous economic revolution. It is based, I think, upon the social and political feeling which is very wide-spread in this country that the enormous aggregations which were obtained from getting up our magnificent inheritance and the conquest of nature by science, valuable as it may be from an economic standpoint, is injurious to the public health and to the future political career of the United States from the social side.

I think that the contest just now on in Congress between Mr. Mellon's 25% rate and the higher rates that are proposed by Mr. Garner, rather fitly represent the contest between the two ideas of an economic tax and a social tax. I ought to say in parenthesis that I am not an income-taxer, a financier or an economist. I am just giving you a few ideas which have come into my mind with regard to it. I think, as I say, that the Garner tax is a social tax. It is a tax like the inheritance taxes which, as you know, run up to 25 and 30%, based on the desire to redistribute the wealth of the United States. That may be a very desirable thing. It may not be. I haven't any idea, but the interesting thing to speculate on is how this repressive tax, a tax of 40, 50 or 60%, as they have been in the past, can be laid on the development of wealth and at the same time that the American people can retain that splendid initiative which has always characterized our economic development.

I don't know whether these suggestions that I have made will be treated by the gentlemen who are to follow me tonight. They are points that interest me very much. There are three subjects that are always open for discussion in the United States, and one can always start to talk on any one of them: The Tariff, The Volstead Act, and The Income Tax. We have got the Income Tax tonight, and the officers of the Club feel very much complimented that so many of you should have ventured out on this extremely stormy evening to listen to the discussion which will be conducted by very expert minds on this very interesting subject. The first speaker, gentlemen, is one who brings to bear not only a keen mind, but a very long training in the subject of banking, Mr. Fred I. Kent, Vice President of The Bankers Trust Company. (Applause)

First Speaker

Fred I. Kent

Vice President, The Bankers Trust Company

Mr. Chairman and Gentlemen of the Economic Club: As you gentlemen have been courteous enough to come out this bad night to hear about the Income Tax, I will take up my subject immediately.

The problem of the Income Tax is clearly bound up in one simple question – What is to the best interest of the people of the United States? Not what is to the seeming interest of any class or group, but what is to the greatest interest of the whole people?

While the desirability of a reduction in the rates of the Income Tax is generally admitted, yet the reason why this is important having such a bearing on the method of reduction that should be undertaken that they should first be considered. It would, of course, be useless to pass any law carrying reduced taxes that would not accomplish that for which the reduction was undertaken. It is therefore essential that we understand what we are striving for.

Every individual who pays taxes would welcome a condition under which he could have good Government without the necessity of anyone having to pay taxes. But Government cannot exist without an income and that is only available from profits, either upon its own operations or those of its citizens, or from both. Government operation is, of necessity, inefficient and wasteful. Errors of judgment, over employment and bad management, instead of standing out in periodical statements which stockholders may see and correct, as in the case of private operation, are covered up by increased taxation when Government operates. Further Government in commerce, finance or industry is in competition with its own citizens, whereas Government is primarily created for the purposes of furnishing protection to its people and to render fair judgments when there are conflicting desires among them.

Usually those who demand government operation with the loudest voices are those who respect Government the least. Because liberal Government is irksome to them, they seem to think more government would be less so, but with many it is borne of the hope that they may be of the Government itself in case of an upset. Government operation being unsound in theory and disastrous in practice, Government should receive its income from the profits of its citizens and that means from taxation. It is to the greater interest of the people, therefore, that they maintain Government by giving it a part of their profits or income than for Government to endeavor to make profits itself.

We now come to the question as to what proportion of his a citizen should give to Government in the form of taxes? The answer in principle is simple and would be the smallest amount that would enable Government to function properly and carry out effectively the purposes for which it is created. To this extent it is to the interest of every citizen to be taxed to create income for his Government, but beyond this point it is a detriment to every citizen to pay taxes himself and to have his fellow citizens pay taxes.

This is true both from the standpoint of the Government and the people. Government, which has more funds than it requires, becomes increasingly wasteful as those in Government who are intelligent and patriotic have less power to prevent compromise with the ignorant, inefficient and dishonest, than if economical administration is obligatory. The influence on those employed by Government who have little or nothing to do is degenerating and the activities of useless

commissions and useless Governmental departments are detrimental to the development of a country.

Men in the employ of government are not producers, but they are consumers and they enter into competition with the regular citizenship for their food, clothing and other requirements, and they use the proceeds of the taxes paid by such citizens to increase the cost of living to those who pay the taxes. Needless expenditure by Government therefore increases prices to the people. Just now the farmers are complaining because of high prices of articles produced by industry. Think of the possible annual production of each surplus hundred thousand men who are in Government employ and what it would mean to the farmer if they were engaged in production. And how many such units of one hundred thousand men are there in Government today, including City, State and Federal branches, which could better be engaged in industry?

There are at present 2,700,000 employees on the payrolls of the Federal and local Governments in the United States and 700,000 former employees drawing pensions, or a total of 3,400,000 persons who are being provided by government with their living. There are between 41 and 42 million people in the United States gainfully employed, so that in effect every group of eleven citizens gainfully occupied is supporting one citizen of Government.

The amount paid for personal service by Government, Federal, State and local, represented

6-1/2% of the National Income in the year 1922. This amount was nearly one-half that which was paid out in wages by all manufacturing plants in the country in 1921, according to the United States Census Bureau. Further this sum represented an average payment of \$91.00 for each person over ten years of age engaged in a gainful occupation.

In one of the European countries over 10% of the people live off of the Government and they enter the market places with money obtained either directly or indirectly from the 90% and in effect bid against them for their food and clothing with their own money.

It is clearly to the interest of all the people that government receives no more in taxes than the maximum amount required to enable government to function properly.

Let us now consider the tax payer. He received wages, or profits, or both, and from them he buys his living and his pleasure and with what he has left he pays his taxes and the remainder he saves. His savings, if small, may go into savings banks until an investment fund has been built up, but both the savings banks and he himself must invest conservatively, which means in securities that are based upon industries that have proved themselves through consistent operation. Savings placed in life insurance must be similarly invested by the Life Insurance companies. There are no funds here for research, for new developments, to forestall the probable requirements of growing populations, or to maintain the arts and sciences. But there are other men whose savings are not small. Men whose ability and attention to business, or whose good fortune, have resulted in giving them large incomes. It is upon such men that the people have to

depend for progress in convenience of living and for the development of science and art. They can afford to take the chances that lie within all new projects, whereas the man with a small income is not justified in doing so. The investments of men of large incomes in such propositions are induced by motives of philanthropy and for profit. In either case, when they are successful, they result in great benefit to the people. This does not include the dishonest who unfortunately are found in all classes, as they should not be considered when principles are being studied, but their activities should be controlled from an entirely different standpoint.

For all normal men and women desire something more than they have of position, mentality, or both. Such desire can function through envy and jealousy, or through honest effort to obtain a higher place in life. In the first instance, it produces stagnation in humanity, and, in the second, progress.

A large percentage of our people have stood for honest effort and as a result our progress as a Nation has been really marvelous. But we have been absorbing people from many Nations where there has been great stagnation and, until they learn our ways, we must expect more of envy and jealousy.

This all leads back to the question of taxes and this is what it tells us. After the maximum amount that Government should receive in taxes has been ascertained and it is found what portion must come from incomes, it should be collected from the people in such manner as is fair and just and

that will cause the least break upon progress and the method of division should be free from politics, envy or jealousy. Nothing should be done to discourage enterprise or curtail the ability of the successful to engage in experimental investment or expansion to meet growing and changing needs.

After practicability has fixed the minimum income upon which a tax should be levied, the percentage to be taken from that income should be fixed so as to leave enough for comfortable living, proper recreation and reasonable saving, and honest Government would never require more in times of peace, except in an emergency. Then a progressive tax should be scientifically figured out that would apply to higher incomes but that would not be confiscatory in its nature or result in the stagnation of enterprises. It is very probable that under normal conditions a maximum surtax of around 12% would yield the best results from every standpoint.

Various economists have figured this all the way from 10% to 15%. At present, however, in view of the war legacy of indebtedness, 25% would seem a proper rate. In ascertaining this percentage it is necessary to consider fully the tax exempt securities which are outstanding, as the figure which it is desired to reach is the one that should give the United States the greatest return in taxes and also leave a sufficient proportion of income in the hands of men of wealth to furnish them with the impulse to make expenditures for research and investment in new developments.

If this is not done, the government will lose in taxes, as investments will be turned into or continued in tax exempt securities. There is not the slightest temptation to men of large income to take the risks that inevitably surround projects which have to do with meeting probable but undeveloped needs of the people when a large proportion of any profit that may accrue will be taken from them. Men who were formerly in the habit of making such investments have to a very large extent withdrawn from such fields. This is shown clearly in the falling off in the number of large incomes paying income taxes, which in 1916 was 1296, and in 1921 was 246. The effect in taxes available to the Government, because of such falling off, is shown in the fact that the total taxable income of this same class dropped during this same period from \$1,000,000,000 to \$150,000,000 and during a time when the reported income of the country had increased from 6 billion to 21 billion.

It is possible that we may be able more clearly to see this situation if we look back to the time in our history when vast amounts of money were being invested in railroads, which were being built through unsettled country. It is not conceivable that if our present income tax had been in force at that time that men would have risked their money in such manner, and instead of the railroads having been built before they were required, so that men could settle adjacent to them, knowing that they would have needed transportation facilities, the railroads would not have been constructed until the pressure of population had become so great that practically all risk in railroad building was eliminated. Had such a situation prevailed, our progress toward comfortable living would have been slowed up tremendously. This is only one instance of the

effect of high surtaxes, as such a situation would follow through every line of development covering the changing needs of the public.

As the density of population increases, it is necessary that new development along innumerable lines keep pace with it, or stagnation is certain to result. Look at china, for instance, which has remained in practically a stationary condition for generations and generations; because there has been no effort made to provide the convenience of life that make it possible for large populations to exist comfortable.

If we should continue our present income tax indefinitely, we could confidently expect that as soon as the present impetus which exists in our Nation had spent itself, that our energy would begin to die down and we would lose our force as a Nation and the confiscatory nature of the surtaxes would be one of the principal causes for such a result. It is necessary, therefore, if we would continue to make progress that our income tax be readjusted and on a scientifically correct basis. That this was not apparent to our politicians was shown very clearly when Secretary Mellon suggested that the taxes be reduced this year, regardless of politics but for the benefit of the people. It was a courageous thing to do and it is very difficult to understand what proper motive Congressmen might have had in resenting Secretary Mellon's action.

For the reason already given it is clearly to the interest of the people of the United States that their taxes be reduced. Why then should there have first been hysteria in Congress when the

suggestion of reduction was made, to be followed, when the proposed Income Tax Bill was examined and found to be scientific in character, by melancholia? Of course, reduced taxes mean that lawmakers do not have as much to spend and this thought may have been in the minds of such objectors as had in contemplation the expenditure of vast sums to meet special hobbies. Then the feeling was broadcast that many Congressmen believed that because their constituents who do not pay the income tax directly outnumber those who do, that a reduction in the tax might be avoided.

This was followed by another wave of utterance, which is still active, that leads to the belief that many Congressmen feel that the vast majority of their constituents not having to pay surtaxes, it would be a popular move to keep such surtaxes at high rates. Those who demand higher surtaxes apparently for some such reason at the same time refuse to approve the elimination of tax exempt securities, even though they well know that such action clearly nullifies the effectiveness of the higher surtaxes which they demand.

It is of interest in this connection to note what has already happened since the Mellon bill was introduced. Security houses in New York have been approached by men with large incomes, who have had their investments in tax exempt securities, for information as to how they could increase their incomes, if the Mellon law goes into effect, through the sale of tax exempt securities and the purchase of high return industrial securities. Such men have been led to study the value to them of a switch from tax exempt securities to industrial securities, because they have seen that

the maximum surtax in the Mellon bill would open the way for them to increase their incomes, even though they would have to pay more in surtaxes. On the other hand, if the Garner bill became law with its maximum surtax of 44%, such operations would not be feasible and the law would defeat itself. That is, it would be necessary, in order for the Government to obtain the same amount from taxation, to decrease the reduction contemplated on small incomes, so that those having such incomes would make up the loss in taxes that would be represented in the continuation of investment in tax exempt securities by those having large incomes.

It is quite clear, therefore, that those who are pretending to favor the man of small income are depending upon the lack of intelligence of such citizens for their political support, as the same revenue for the Government could not be raised unless the man of small income was required to pay a larger tax than that covered in the Mellon bill as the estimated total revenue the law would provide is that which the business of the Government requires.

In this connection a most interesting situation has developed in Washington. A majority of the party in power believes that the interests of the people of the United States demand that the Mellon plan be made law substantially as it exists and with the maximum surtax of 25%. A small group of legislators, who were elected by the votes of citizens who are members of this same party, has taken it upon themselves to oppose the majority without apparent reasons, insofar as anyone can judge from their statements, and upon analysis it is found that this group largely represents States which pay directly a comparatively small proportion of the income tax. In effect, if it were possible for this small group to prevail by betraying their own party and joining

with that of their opponents, the people in the four States, which together pay over 50% of the income tax, would be in the position of being taxed without representation, as the predominating force of their representatives would be absolutely nullified.

Now the true of the matter is that the constituents of those who come from states where the average ax paid is low are paying higher prices for everything that they buy because of the high income tax, together with the 12 billion odd dollars in tax exempt securities which are outstanding. Further, they are paying for the waste that has been going on in municipalities which have been led to borrow unnecessarily because of the low rate at which they could put out their securities. The money of those with high incomes instead of being invested in prospective enterprises and in certain classes of development, which are so necessary if our population is not to outstrip our conveniences, has been spent in unproductive ways and when the proceeds of the expenditures have worked their way here and there into industry, it has been entirely along the line so present development.

In the States, therefore, where the average payment of income tax is low, they are as vitally interested in having a reduction of the taxes, including a reduction of the surtaxes, as is true in other states.

For instance in South Dakota where the average income tax paid is \$1.80, they have a higher percentage of automobiles to the number engaged in agriculture that in any other States of the

Union, with the exception of four. They purchase a large quantity of agricultural machinery and they buy many other kinds of goods, all of which carry within them taxes that are probably paid in large part by those in the four States in the Union which pay over 50% of the whole Income Tax. This incidence of such taxation may be direct or indirect, but it unquestionably exists in one form or the other.

The largest number of citizens that is practicable should be required to pay a tax. Every paying citizen is a more responsible citizen, and if the legislator knows that the vast bulk of the people are interested in his votes that require the expenditure of money, he becomes a safer lawmaker than if he has the knowledge that few are interested because few pay directly and the balance of the people cannot see the indirect cost to them.

It is quite apparent that many legislators prefer that a few pay all the taxes, and probably for this very reason and they are the men who should be watched. The legislation which they favor will very likely be found to be class legislation, which in the end always proves as harmful to the class being favored as to the whole people.

It is interesting to note here that of the 41 to 42 million people in the united states engaged in gainful occupations, plus such other citizens as may be living from their incomes, only 6,662,176 made income tax returns in 1921 and that a large percentage of those making returns paid no tax. It is possibly quite natural that some legislators should feel that the vast majority which does not

pay the income tax direct is willing to have those who do pay continue their payments because those free from the tax cannot see how they are indirectly affected. The incidence of taxation is sometimes very difficult to follow, particularly in an income tax, and more especially in a surtax. There would seem no question in the case of the latter that such surtaxes as are actually paid cannot be passed on, but this fact does not prevent too high surtaxes from increasing the cost of living to the whole people. When men put their income into tax exempt securities, the proceeds of which have partly been wasted, as has unquestionably been true in the case of most tax exempt securities outstanding, the increased cost to the public comes from two sources -- first, through the payment of local taxes to meet such waste as has occurred in the expenditure of the proceeds of the tax exempt securities, and second, because the funds which have been put into such securities have been withheld from industry and pioneer development, which of necessity increases prices. There is also a decrease in the comforts of living, as changing needs are not anticipated.

The blind desire, therefore, that seems to exist in the minds of so many to overtax men of large incomes, merely to take their money from them is nothing but a species of envy and jealousy or politics which depend upon the existence of such unfortunate characteristics. This policy is unquestionably against the interests of those with small incomes and kills that desire which all men naturally possess to better their mode of life, because they can see that the rewards of successful effort are unfairly penalized. When the problem of the surtaxes can be separate from

envy, jealousy and politics, and not until then can it be solved in such manner as will prove to be to the best interests of the whole people.

It has been necessary to set up tremendous machinery in connection with the operation of the Income Tax Law in order to check up the citizenship. There are two positive sides to the question of the avoidance of taxes. One has to do with those citizens who may be dishonest and who would not pay a tax unless forced to do so under any circumstances, while the other is represented by the vast bulk of the taxpaying population which pays taxes under mental protest, because it realizes that it does not get a proper return from Government. Legislative and administrative waste is, of course, at the bottom of such mental protest and if legislators would encourage citizens to pay their taxes by reducing Governmental waste to a minimum they would find the whole tax situation a much happier one and one whose operation would not cost the Government nearly what it does today.

Ordinarily it is found that those legislators who cry out the loudest against the avoidance of taxes by citizens, even though it may be legally done, are the ones who, on the other side, are willing to vote for uneconomic bills covering propositions in which Government should have no part. The people should stop and consider just what this means, for it is only after such study that they can determine whether or not their legislators are the proper men in whom to put their trust.

There has been more or less objection made by Congressmen because they have received from their constituents letters favoring the Mellon Tax plan, many thousands of which have been on printed forms. While some Congressmen may prefer not to believe that their constituents are in earnest when they urge passage of the Bill on printed forms, yet actually they must know that it is not for them to say how a citizen shall record his opinion any law that may be before Congress, provided it is done legitimately. If, therefore, citizens go the trouble to sign statements, recommending the passage of a law, even though they may be set up in type and may have been furnished by any interests whatsoever, and then address, stamp and mail them, it is as clearly an expression of the opinion of the citizens as if they made the statements in writing in their own words. As a matter of fact, Congressmen ought to welcome statements in such form, as it puts them in position to quickly ascertain, with the least amount of work, which of their constituents are in favor of a Bill, whereas if thousands of letters are received, all of which are written out in different forms, the time necessary to study and classify them puts a far greater task upon the secretarial force of the Congressmen, than when printed forms, which can be quickly sorted, are used, It s hard to conceive how an attempt to ignore the opinions of citizens which may be expressed on regular forms can carry sincerity.

It is strange how far reaching the Income Tax goes into the curtailment of business. A large amount of industrial capital is raised by means of commercial paper, which has in general been found to be a safe and satisfactory means for industrial enterprises to obtain funds needed for current operations in addition to their regular banking lines. The Income Tax Law, together with

the outstanding tax exempt securities, has seriously affected the marketability of such paper and has therefore injured industry to that extent. The reports of the Federal Reserve Bank of New York indicate that \$1,296,000,000 in commercial paper was outstanding on December 30, 1920, whereas in November, 1923, only \$788,000,000 was outstanding. The reason for such reduction has been partly due to the Income Tax rates, together with the tax exemption on outstanding securities, as many former buyers of commercial paper have actually stopped their purchases on this account and the market has therefore been seriously curtailed.

The Federal Reserve Act was conceived in part to enable the development of an acceptance market in the United States in order to further our foreign trade. The issuance of tax exempt securities has seriously affected the market for acceptances and to the extent of such curtailment of the market has directly handicapped our foreign trade and will do so even more when European conditions become more normal.

In order to meet his taxes in 1913, the average person had to work 3-1/3 weeks, whereas in 1922, it was necessary for him to work 6-1/4 weeks 0 that is, the average citizen of the United States in 1922 spent one-eighth of his time working to provide taxes for the Federal, State, County and Municipal Governments, and it is fair to assume that the incidence of such taxation touches all people by increasing the cost of living.

The need for the reduction of taxes is beyond question, but such reduction should be scientifically carried out, or the greatest good to all the people cannot be attained. The records of all income taxes paid since the opening of the war are in the books of the Treasury Department. In working out the Mellon plan for reduced taxation, such records were studied by experts in the Department and the information was put before Secretary Mellon for his consideration. There is probably no man in the United States better fitted to draw conclusions from records than Mr. Mellon and his every exposition of his plan has proven beyond doubt that it was developed along lines aimed to serve the best interests of the people of the country. His correspondence with his critics has in every case resulted in their defeat, even though such defeat has only been admitted in some instances by the ungraceful method of personal attack. Insofar as the public is aware, no plan has been suggested in opposition to the Mellon plan, which has been scientifically prepared or that carried within it anything except supposed political exigency.

It has been clearly shown that the Garner bill would not bring the desired result, insofar as the total amount of taxes is concerned, and it carried within it inconsistencies which are apparent to anyone who is willing to give the matter any thought. It is inconceivable that a people with the average intelligence which prevails in the United States can be fooled by such attempts to play up to what is thought to be massed desire.

After running the gamut of all the criticism of the Mellon plan, one cannot find a single argument against it which has to do solely with the interests of the people of the United States. Instead

practically every change that has been suggested, except in unimportant minor details, has been clearly of a political character. The importance of the passage of the Bill is such that all citizens should emphasize again to their Congressmen their desire that the Bill be passed with its principal provisions intact. As the time approaches when the Bill is to come to vote, Congressmen should be made to realize that the people are still interested and they should not be allowed to forget the demand of the people that has already been made upon them to pass the Bill. In the excitement of the political turmoil that now exists, it is too easily possible for the force of the past expressions of the people to be lost sight of, and if we wish to prevent our country from rapidly moving toward a point of stagnation, it is going to be necessary for the people to keep alive to the situation.

Let us therefore demand of our Congress in no unmistakable terms that the Income Tax Plan, which has been so carefully prepared with the interests of the people in mind by a Secretary of the Treasury, who has shown ability second to none, and that has been recommended by a President of the United States, whose judgment is rare, whose wisdom is unquestioned and whose honor and integrity are above reproach, should become the law of our land. (Applause)

MR. OSBORN: I am a strong believer in the Mellon Plan, but I sometimes wonder whether the argument with reference to the decline in millionaires' incomes, I mean incomes of a million or more, has not been a little overstressed. To me, when you look over the income account of the United States, there are several things which make it very doubtful whether the great drop which

was mentioned by Mr. Kent was entirely due to the refuge in tax exempt securities. We all know that money has not been made in the large amounts such as existed in the earlier years, 1916 and 1917. There are several large industries in the country which formerly produced enormous incomes which are no longer largely profitable, for instance, the lumber industry. The cut of lumber is very largely reduced. I came through the Southwest last week and I was amazed to see the number of huge mills that were idle and the reason that they were idle was that the cut was exhausted. You all know that the copper industry which furnished many very large incomes has suffered a great decline in the last four or five years. There is another great industry which was productive of huge incomes for many years and that is the cattle industry. The cattle industry has produced no large incomes. It is more likely to have produced a deficit during the last four years. Then there is another feature with regard to refuge in tax exempt securities. Who is it that can go into tax exempt securities? Why, it is the man whose income is derived from marketable securities. He has got to sell his railroad bonds or stocks. He has got to sell his industrial securities in order to get into tax exempts.

Now, a number of people in the United States who drew their income of a million or more a year from securities without the aid of some large industrial enterprise with which they were connected was relatively limited. There is another feature, and that is the hope which springs eternal in the human breast has operated with many men to prevent their selling their securities, although they were aware that the tax at the present, or at the time, made it advisable, for the

reason that they hoped that the huge surtaxes would be reduced, as at present there is some hope of our having.

There is one further observation that I wish to make with regard to the great care in the scrutiny of your income tax returns and in their careful preparation. Under excellent legal advice, no man need feel in the slightest that he is doing wrong to his country or to its history if he is very careful in preparing his income tax statement. You will remember that the Government of the United States originated in the Boston Tea Party.

Now these various items, I think, should always be considered in taking up the subject of the effect of tax exempt securities as a refuge for large income tax payers.

The next speaker is one whose name was for many years somewhat of a terror to us all.

(Laughter) I have the honor to introduce a very able citizen who has had very close experience with the collection of income tax, for he was himself the Collector of Internal Revenue of this Port from 1914 to 1919, the Honorable Mark Eisner. (Applause)

Second Speaker

The Honorable Mark Eisner

Collector of Internal Revenue

Mr. President, Ladies and Gentlemen of the Economic Club: I feel rather diffident after the very philosophical and interesting discussion which Mr. Kent has just concluded in taking the stand myself, because I fear that I won't be quite as philosophical as he. I also regret that I cannot help and enliven you with a dispute or a disagreement with the speakers tonight. I had hoped that Senator Copeland would be here, (Laughter) because the Senator is a Democrat, and I am a Democrat, and when two Democrats get together, as Mr. Osborn knows, they never can agree. (Laughter)

I trust that the fact that I am going to take up, in a measure, the administrative features of the tax law, won't bore you too much. I don't want to be in the position of a certain income tax expert that was delivering a lecture to some association on the intricacies of the income tax law, and after he finished, asked whether there were any questions, and the answer was complete silence. He repeated his question "Has anybody any question to ask?" And someone in the back of the room piped up, "What time is it?" (Laughter)

All of the discussion, gentlemen, on the Mellon Bill seems to have been concentrated on the subject of the rates. That has been the all-important topic of consideration in this country and practically no attention has been paid to the other features of the bill, the changes that have been wrought in the administration of the tax law and some of the substantive legal changes that are proposed in the bill.

Now it seems that the rates of the Mellon Bill cannot get by in this Congress, and that the rates will probably be increased. I don't know what the Senate is going to do. I don't know what the Conference Committee of the Senate and the Congress will work out but I think it can safely be said that whatever plan is finally consummated the rates will be increased.

Now then there comes a very important question for our consideration. Secretary Mellon planned his bill as a homogeneous whole. He planned the balance of the bill to meet the reduction in the rates that are proposed in the measure and, now let me tell you where that affects you. Because of the very generous rates of the Mellon Bill, certain other transactions, certain agreements, are taxed where they never were taxed before. Evidently Secretary Mellon thought, and properly thought, that if the tax rates are going to be depressed the citizens of this country should not object if certain transactions were included as taxable that heretofore had not been so included. Now the House Bill raising the rates of the Mellon Bill will undoubtedly include as taxable objects the transactions which the Mellon Bill for the first time taxed and therefore, unless we are careful and watch the legislation that is going on we will find that we are getting it going and coming, a higher rate of taxation and more taxable transactions.

For instance, under the present law, if I make a trust for the benefit of my wife or of my children, even though that trust is revocable in its form, and even though I may be able to get the part of the income from that trust myself, the trust, or the income from the trust, is not taxable to me. It is separately taxable. Now the Mellon bill, under its provisions, the income from a revocable

trust for the first time becomes taxable. That was fair under the Mellon rates. It is not fair if the rates are increased.

Now, gentlemen, to show how Congress really operates in these things, take the question of community property. You know there are six or seven states in the United States that derive their basic legal principle from the French or roman Law, and in those States, notable Texas, Louisiana, Idaho, and also the States of Washington, California, Arizona and New Mexico, all of the income derived by the husband from property or from his earnings is treated as one-half his and one-half his wife's. Even though he has complete control of it and she has none. The Federal Government therefore in States such as those I have mentioned allows the husband for income tax purpose to return one-half of what he earns as his own income and the other half as his wife's income, thus of course, through that splitting of the income, reducing his surtaxes. The Mellon Bill sought to change this and provided for the taxation of the income in community States and community property as all of the husband's income, so long as he retained control. The House Bill changes the Mellon Bill, leaves the community property rule as it used to be, but it did not change the Mellon bill with respect to family trusts and certain other provisions, so that if you, in a State like New York, see fit to establish a trust for the benefit of your family or certain ones in your family, under the present bill in the House the entire income will be taxed to you provided there is a power of revocation, whereas down in Texas and Louisiana and these other states, the law still will remain that the income of the husband will be considered divided between him and his wife.

If I am not boring you too much with the consideration of some specific provisions, I want to take up still another. We have heard a great deal about this question of tax exempt income, the return from tax exempt securities. I am not going to enter into a discussion now as to the wisdom of making tax exempt income taxable. I am not altogether sure or convinced that we should change the present law, but there are certain provisions in this bill which, if they go through, seem to me to be unfair because they are indirect. They seek by a method of indirection to reach for taxation income from tax exempt securities, and this is how they do it. If the present bill goes through, and this is one of the features of the Mellon Bill which the House of Representatives seems to desire to retain, if you have income from tax exempt securities and you also lose money either on the sale of property or in a transaction in Wall Street, assuming that money can be lost in any transaction in Wall Street, (Laughter) you cannot get the benefit of the loss except to the extent that your loss exceeds your income from tax exempt securities, which is just another way of taxing tax exempt securities in the hands of a man who happens to take a loss. If you do not take a loss you would get the benefit of your tax exempt securities. Furthermore, take the case of a widow who has a small income derived from a piece of property on which she has a mortgage and pays interest on the mortgage, and she also has certain tax exempt income. Under the present law, or the present bill, rather, she will only be permitted to deduct so much of the income that she pays on her mortgage as exceeds her income from tax exempt securities, and I do not think that that is a provision that ought to be allowed to remain.

I have only cited some of these things generally for the purpose of urging you to pay attention to other provisions of these tax statutes, rather than confining yourself exclusively to those portions which are the subject of discussion in our public prints.

Now, this very interesting topic of earned income, the Mellon Bill provided, and rightly so, that the income which is derived from wages, salaries, professional earning, shall be taxed at a lower rate through a 25% credit arrangement than for other income, and the Mellon Bill set no limitation on this, the principle being that anything that a man earns through his own services, and which are not the result of his capital investment, should be taxed at a lower rate. The House Bill changes the Mellon Bill and provided that after \$20,000 no income shall be considered earned.

Now you and I know that when it comes to the professional man, when it comes to the high-salaried executive, the reason he is getting more than \$20,000 is because his earnings are at the expense of something vital. It may be at the expense of his health; it may be at the cost of shortening the days of his life. The big surgeon, who in a brief span of years, is enabled to build up a large income at tremendous nervous and physical effort and expense, should not have it taxed away from him even though he may be earning over \$20,000. (Applause)

I know the case of a certain lawyer who worked for ten years on a certain large matter, practically to the exclusion of every other item of business, and earned a fee of \$800,000 because

of this work extending over ten years, and paid over half of it, considerably over half of it, to the government as taxes when he got it. I suppose I will be called down now before the Senate to tell them the name of this lawyer. (Laughter) I used to hear, when I held office as Collector, the complaints of the movie people. You take the movie actress whose face is her fortune, or presumable so. (Laughter) her earning are confined to the very short span of years when her face is able to earn its maximum productivity, and yet if you are going to set a limit on her earned income for the purposes of taxes, I think you are working a manifest and grave injustice upon her.

Now, the Mellon Bill, as well as the House bill, provides for a Board of Tax Appeal. A great many of us in our dealings with Uncle Same have grown dissatisfied with the method of handling cases, and when we finally find ourselves in disagreement with the Treasury Department we do not like the idea of having to pay our taxes first as a preliminary to going to court and litigating in court our contentions with the Government. So, therefore, this bill provides for a Board of Tax Appeal which will consist of not less than seven nor more than twenty-eight members, and it is thought that this will eliminate a great many of our difficulties, and I am afraid, that as stated in the measure, it will not. I am just going to show what would happen in an ordinary case with the present Board of Tax Appeals. I can show you where you may have, in a case of sufficient importance, seven different appeals to go through, which is all right for those who are handling the appeals on a basis of compensation, but it is not all right for the taxpayer. You will first have a revenue agent examine your books. Then, when he has made

his report, you go down and dispute it with the revenue agent in charge. That is one hearing. If he decides against you, you will have a hearing in Washington. That is two hearing. It is inconceivable to my mind that the Commissioner of Internal Revenue is going to allow you to go from your first hearing in Washington to the Board of Tax Appeal without some intermediate hearing by way of review in his department, because your first hearing in Washington is only in the presence of two subordinates of his. So you will have a third review hearing and then if you are still unsatisfied you can go to the proposed Board of Tax Appeal. And let us say that you become greatly elated because the Board of Tax Appeal has reversed the income tax unit and has decided in your favor. What then? It is then provided that the Government has the right to appeal to the courts and so, after your four hearings, you will have a chance in the United States District Court, with you as respondent and the Government as the appellant. And from the United States District Court you may find yourself covered with the glory and distinction of having your case in the United States Supreme Court for a final adjudication.

Besides this, once you have a presidentially appointed Board of Appeals, with men secure in their office, you cannot get away from it, they will become tinged with the Governmental attitude in the consideration of the cases. The mere fact that the President appoints the Federal Trade Commission, for instance, does it mean that the Federal Trade Commission has ceased to be a hide-bound branch of Governmental functioning? It is, and it cannot get away from it. Once you are with the Government or, rather, once you are of the government, you are with the government. I know that. You cannot avoid it, no matter how much you really try.

Now there is just one other little provision that you, as business men, may be interest in knowing, and which I call to your attention primarily for the purpose of showing how important it is for us to consider the administrative features of these tax measures. Many of you may have received within the last few weeks notices that the Government is going to assess you for the year 1918, because 1918 is not all finished yet. It is going to assess you an arbitrary sum as taxes because if it does not the Statute of Limitations will run against the right to assess, and the notice that gives you the amount of the assessment tells you that if you file a claim for abatement with the collector you can get a hearing on that abatement and have the assessment adjusted, on the basis of the amount proved to e due, if anything is due. Well, there is no harm in that. It is a proper and normal thing to do, provided you concede that the Government should have five years to adjust your taxes. But the new bill says that if you file this claim for abatement with the collector, you must accompany it with a bond in not more than twice the amount of the proposed assessment. Now, these jeopardy assessments, as they are called -- jeopardy because the Government's right to collect it is jeopardized through its sleeping on its rights for nearly five years -- these jeopardy assessments are usually arbitrary. They are often vastly excessive in amount and yet you, the taxpayer, will be compelled, in order to avoid a levy on your property, to put up a bond, usually a surety bond, in order to protect the Government against the Government's own neglect.

Now, I can predict for you that a provision like that, snuggling inoffensively among the other provisions that the public is discussing, will pass without question unless the taxpayers see fit to

notify Congress how they feel on provisions of this character. Now, gentlemen, I have kept you with the consideration of these things about as long as I have a right to without someone asking me what time it is. I do hope and join with Mr. Kent in the expression of that devout wish that the time is going to come when the question of taxation and tariff and these other economic considerations will be completely divorced from politics. I hope the day will come when we will have some kind of a commission, let us say, although I am rather tired of these commissions that Congress authorizes to do work that someone else is too lazy to do, just like committees in clubs, et cetera-- I hope that the time will come, however, when a commission will be appointed that will consist of men who are divorced from politics, who are representative in the particular walks of life that they pursue, men like Professor Seligman who is to follow me, Dr. Adams of Boston, who has done wonderful work in the shaping of legislation, leaders of the industries, men like Mr. Kent, men who are competent and who have no selfish motive in framing legislation; a committee of that kind, to recommend to Congress what should be changed in the law, and such a committee, composed of men that Congress is willing to follow and dare not refuse, will, we hope, arrive at a solution of the difficulties that harass us today and make our contact with our Government, instead of pleasure and service, one of self-sacrifice and irritation.

(Applause)

MR. OSBORN: I am sure we all feel much indebted to Mr. Eisner for his interesting and somewhat terrifying analysis of the present situation.

The next speaker is one who has addressed us I think two years ago on the interesting topic of the European financial situation, and tonight he is to bring his ripe wisdom and his trained experience to bear upon this topic which touches us so nearly, Professor Edwin R. Seligman, of Columbia University.

Third Speaker

Professor Edwin R. Seligman

Columbia University

Mr. President, Fellow Members of the economic Club: The problem of taxation is really a threefold problem, or, at least, it may be approached from three different points of view. There is the administrative side upon which the preceding speaker has so interestingly and masterfully touched. There is the political side, and there is what may be called for lack of a better term, the scientific or the economic side.

I regret more than almost any of you present the absence of Senator Copeland, (Laughter and Applause) not alone because we would have the opportunity of listening to a possible Presidential candidate, but also because he would have brought before us a point of view which has not yet been touched upon, and it is one from which we cannot extricate ourselves, -- the political side of the question.

I wish that I could agree with the preceding speaker in thinking that politics in this matter, as in so may others, might be relegated to the dust heap of oblivion. The political side of the question is, after all, the foremost side of the question with us. I do not speak of it in the sense of petty politics or even of partisan politics, but in the bigger sense of true politics, or true statesmanship, because these political views represent divergent social interests. We see it in Congress at the present moment when there is not simply a line-up between the Republicans on the one hand and their Democratic opponents on the other, but when, as in the vote of yesterday, we find Democrats and Republicans voting together against certain Republicans. The political point of view represents certain very well defined divergent social interests, and it is not for us, and I say this just because Senator Copeland is not here, -- it is not fair for us here in New York, in the nerve center of our great Empire, it is not fair for us to assume that those who do not agree with us in this matter are actuated simply by motives of greed or malice or Socialistic effort to confiscate fortunes. That was a mistake that we made, and we almost rued it in the great silver agitation of a generation ago. The mass of this people is sound at heart. It wants to achieve what it considers justice, and the problem simply is for us to consider how can this equality, how can this justice be best achieved? We must not sling mud at them, nor must we permit them to sling mud at us. We must try to understand them. They, again, should try to understand us. That is what I meant when I said a moment ago that there is, in addition to this administrative and this political side, what you might call an economic or a scientific side, a study of what actually may be supposed to be the consequence of a change in the law, and here, fellow members of the economic Club, both sides have committed grave errors. There have been extremists on both

sides, and arguments have been advanced by the one and by the other which, on a calm view of the subject, represent positions that are really untenable, and I am going to devote just a few minutes to consider a few of these untenable arguments on both sides in order to put us in a position to approach the subject without heat, and with a little more light.

In the first place it has been said by the advocates of the Mellon Plan -- I was glad to see that Mr. Kent is not among those extremists-- but you find it reflected in the newspapers, and I fancy that most of those present tonight have a vague sort of an idea that an income tax is shifted to the community in the shape of higher prices.

If it is true, as the ordinary businessman thinks, that the expectation of a high income tax will lead him to mark up the prices of his goods and then charge the ordinary profit on this increased cost, and that is an opinion widely held by the average businessman, what more simple method would there be of increasing profits than by levying a stiff income tax?

As a matter of fact, why is it that the ordinary man among the consumers opposes a sales tax and favors an income tax, and why is it that the ordinary businessman favors a sales tax and opposes an income tax? Simply because at the bottom of his consciousness, on both sides, there is a feeling on the part of the businessman that the sales tax he can pass on to the purchaser and that an income tax he has got to pay himself. Otherwise he would not object so much to the surtaxes, and as a mere matter of economic principle if it could be shown, if it were not entirely too

elementary and too invidious to spend the time upon that, that a tax upon business profits, which represents a surplus over cost, and not cost, cannot be shifted in the shape of higher prices in the same sense that a tax on sales or a tax on output can be shifted. But, without dwelling upon that any longer, I will call your attention to this point, that it is unnecessary to argue, as it often has been argued in the papers, that an income tax is necessarily shifted to the consumer in higher prices, and it is also unnecessary to argue as has been done by some of the extremists in favor of the Mellon Plan, that whatever is spent by the Government is unproductively spent and whatever is spent by the individual is productively spent.

I do not deny for a moment, of course, that taking the thing by and large we should not be advocates of the Soviet system. We do not believe that the Government action, on the whole, is either so economical or so efficient as private action. But, in those fields into which the Government has entered in a conservative democracy as ours is there any justification for the common statement, so often repeated in the papers, and even at times hinted at by Secretary Mellon himself, that Government expenditure is unproductive whereas all private expenditure is productive? May I ask you as to whether the money spent by the County or the Municipality or the village or the State in building good roads is not, perhaps more productive in the best sense of the term than the investment by private individuals in factories that make munitions of war? And is it not true that the money spent by Governments in building schools is more productive, perhaps, than the money that used to be invested in this country in the making of liquor? Is there, in other words, any justification for the extreme statement that whatever is done by the

Government is bad and whatever is done by the individuals is good? Those arguments are not necessary in order to show the strength of the plans now before the country for the reduction of the surtax.

On the other hand, the extremists on the other side who think that Wall Street is necessarily synonymous with everything that is a least suspicious, (Laughter) those also make a very great mistake in thinking that a tax upon the rich does not have its indirect repercussion and effect upon every class of the community. But, only in this way gentlemen. It is perfectly true, as Mr. Kent has pointed out and as Secretary Mellon has very adequately proved, that insofar as you weaken the incentive to enterprise; insofar as you check the effort to accumulation and saving; you prevent, on the one and the increase of wages which would come with the increase of capital under normal conditions, and that you also prevent the lowering of interest which would, under normal conditions, come with the greater accumulation of capital. In that way, by shutting down on possible avenues of expansion, you check the progress of the country. You do not make prices higher that way, as is often mistakenly said, but you prevent wages from rising and interest from falling and in that way, especially if your surtaxes are really excessive, you are checking the progress of the country; you are limiting the avenues of employment; and you are really producing an effect upon the man who thinks he pays no taxes but who, in reality, suffers by the excessive taxes imposed upon the wealthy.

That argument is just as weak as the argument on the other side, and the truth lies in the middle. Whenever you have a system of taxation which really succeeds in checking this spirit of individual initiative, of incentive, of risk-taking, which is the secret of all economic progress, you are dealing badly with the economic community.

But now we come to the point which really lies at the bottom of the thought of those seventeen Republicans who voted against the Mellon 25% rate yesterday. What is that point? The argument that is ordinarily made is that we must reduce the surtaxes because we check the incentive to save and the accumulation of capital. On the other hand, what these gentlemen from the West and the South instinctively feel is the perfectly correct idea that the higher incomes are not all of them devoted to saving and accumulation. What is this process, gentlemen, of saving and accumulation? A man with an income of two or three thousand dollars a year, unless he has a very remarkable kind of wife, finds it very, very, difficult to save anything at all. In fact it is almost impossible to save anything. A man with a somewhat larger income, if he works very hard and sacrifices is able to save a little. As his income increases he finds it more and more easy to save until finally, when you get to the princely income of a Mr. Rockefeller, or the others in that class, if there are any, saving becomes automatic, because I defy anyone with an income of five or ten million dollars a year to spend on his own self, or even upon as many lady friends as he happens to have (Laughter) more than a very insignificant proportion of his immense income. Saving runs through the whole gamut, from practical impossibility to automatic saving. That is what lies at the bottom of this feeling in Washington today. And what is the way out of it? The

reason that there is this opposition to cutting down the surtaxes from the 58% to 25 or 30%, is because it cuts down not along the income which is saved, but the income which is spent. If we could distinguish in some way between the income that is saved and the income that is spent I am quite sure that a great part of this what-you-call seemingly Socialistic movement in Congress would disappear. And while I thoroughly agree with those who think that it is administratively impracticable to make a distinction in rate between income that is saved and the income that is spent, I do suggest that if we could have a lower rate of surtaxes all around, and supplement the income tax with a graduated tax on luxurious expenditure, so that the man who will spend his \$100,000 or \$200,000, or \$300,000, would still pay a higher, a considerable higher, progressive tax than the man who spends \$5,000 or \$8,000, -- if we could supplement a lower tax on all incomes received with a tax on luxurious expenditures, we would, in itself, render feasible this very great reduction in taxes on savings which is desirable and the achievement of which meets with such difficulty in Washington today because of the confusion of those two ideas.

No, it is so, and if the feeling on the part of our recalcitrant radical friends is due rather to a confusion of ideas than any attempt to despoil us, I agree, of course, with the preceding speakers that entirely apart from the shuffling and the squabbling that is going on in Congress today as to whether we should pay 5% more or 5% less, I do believe that the time has come in this country when there must be and ought to be a specific reduction, a substantial reduction, of the high surtaxes in order to prevent the possible, and I think probable, actual restriction upon the fullest utilization of our economic resources. There ought to be a substantial reduction, not simply an

infinitesimal or insignificant reduction, but if that could be combined the way I have spoken with the other, it would be a vast step in advance.

But now we come to another point which is giving us so much trouble politically in Washington, and that is this distinction between the earned and unearned income. I won't stop now to dwell upon the interesting point made by the preceding speaker as to the justifiability of putting a restriction upon earned income. I am afraid I do not quite agree with him. There are, I think, some very notable arguments on the other side, which arguments prevailed in England when Lloyd George discussed it ten or fifteen years ago, and in England, as you know, there is also a limit, but I won't dwell upon that simply because of the overmastering political situation and argument. The farmers, the same people who object to the reduction of the surtaxes, also object to being included with you gentlemen from Wall Street in among the recipients of what Gladstone called the "lazy incomes."

I suggested to Mr. Green Chairman of the Ways and Means Committee of the House a short time ago in correspondence that we have had, that it might be wise to take a leaf out of the book of one of the European countries where, half a century ago, they had the very same fight, and in the very same way, namely in Italy, and the very astute statesman at the head of the Government in those day, just about a half a century ago, decided that they would interpolate between the earned incomes on the one hand and the so called unearned incomes on the other a third category to which they gave the happy name of "mixed incomes," and the mixed incomes are the incomes of

small businessmen and the farmers who employ a small amount of capital, together with their own daily toil and by this happy thought of the mixed incomes, the recipients of the mixed incomes who, indeed, pay a higher rate than the recipients of the pure earned incomes, were then not confounded with the more fortunate recipients of the lazy incomes, and that solved the problem. Why should not we adopt in this country the system of differentiation which is found in several of the European countries and introduce a further category between the earned and the unearned incomes?

We come in the next place to another point which is giving a great deal of trouble at Washington today, and where we have great need of a little further study of the real economic consequences of taxation. You all know that our income tax includes not simply the so called ordinary income from regular or irregular sources that individuals receive, but it also includes what our law calls “capital gains” and we are about the only country in the world which does that. England does not include gains from capital, because they say such receipts are an increment of capital. They are an addition to capital. They are not income. Now that brings up a most interesting question, namely, as to the progress that takes place in the course of time in the very concept of income. At one time, in the beginning, 75 years ago, when people began to discuss this thing, income was everything that comes in the way of money above the expenses of bringing it in. And after a while they extended that and took not alone money, but money’s worth. And after a while they took not along regular incomes, incomes derived in the course of one’s regular business, but also certain forms of irregular income, and finally we, in this country, took in capital gains. Now, that

is a very pretty theory, a very beautiful principle, and I think probably from the abstract point of view much may be said for the adoption of what may be called the accountant's theory of income, and that is just what you businessmen do when you take an inventory at the beginning of the year and another balance sheet at the end of the year and you say, "The difference between the two is my profit", or your income. The trouble is that if you count the capital gains as income you have got to count capital losses as deductions from income, and who is there in this room tonight who does not know what havoc has been created with our income tax because of this provision. Who does not know that in the month of December every year the transactions on the Stock Exchange are greatly increased because of the efforts of all of us to take losses and to cut down our income tax?

Now that finally has reached the powers that be and the new bill now before Congress provides, as you know, for a restriction on both capital gains and capital losses to 12 ½%. How absurd. Why 12 1/2%? Why not 15% or 20% or 30% or 40%? Either capital gains are income, in which case there ought to be 100%, or capital gains are not income, as England says, and then it ought to be zero. But why should we take 12 ½%, that arbitrary figure which eludes and baffles all inquiry? How here again why can we not take a leaf out of the book of some of Europe's experience? What do they do in some of the foreign countries? They do not attempt to say that capital gains and capital losses are income, because they know, as we have now experienced, that it means an immense reduction in our income. I think it is fair to say that if we never had any such provision in our law, if we had never been permitted to deduct capital losses from income,

our income tax receipts would have been greater by tens of millions, if not by hundred of millions, and that we would be able to reduce the rate very much more than we are thinking of. On the other hand, it is not a question of rich man versus the poor man. It is a question of a privileged class against an unprivileged class, which is as it was in the ancient regime in France before the revolution. And what a contrast it is in a democracy which aims at equality, which attempts in one way or another to hold the balance even, to build up year by year an increasing number of people who are legally invited to escape their fair share of taxation. That, perhaps, is the chief of all the reasons for the resentment in Congress today on the part of the so called radicals against the attempt to reduce the surtaxes.

Now, gentlemen, I won't stop to consider, because the time is late, I won't stop to consider, rather only mention, the two chief arguments which embody, in my opinion, the gross economic fallacies. The two chief arguments which have actuated the ordinary man, and especially the ordinary Congressman, to withhold his assent from this bill. Mr. Green is entirely right when he said that the vote that was taken two or three days ago, that this is only the beginning of the struggle, that it is not settled, and that it is going to remain with us and it will remain there until it is settled right. The two chief arguments are these: one is that the inequality is more specious than real, because the man who buys tax exempt bonds has to pay so much more for the bonds and therefore he really pays the tax in the price.

That, I say, is a specious argument and a fallacy for two reasons, one, because the privilege is almost entirely a scarcity privilege. As Secretary Mellon has well pointed out if the entire National debt were to be refunded today and were to be tax exempt, -- he doubts and so does Mr. Leffingwell, and so do others, as to whether you could get a tenth of 1% more for the bonds than you could otherwise, and with the increase of every billion, and we have fifteen billions alone of State and Locals as well as a great many Nationals still outstanding, with every billion increase that argument is going to become weaker and weaker. And the other reason why there is this fallacy, although such a widespread fallacy that it has exerted such an immense influence today, is this: The reason why you have to pay more ordinarily for a tax exempt bond than for a taxable bond is because you discount the future. You think of the taxes that are going to be paid in future and if you were to have a simple proportional tax of 5% or 10% there is no doubt that where you have dealings only with new bonds, in a small issue, as any bond broker will tell us, there is that difference. But who knows today, with the existence of our graduated or progressive tax, who knows into whose hands that tax exempt bond will go? Will it go into the hands of a rich man, who is subject to a 58% tax, or will it go into the hands of a small man who is subject to no surtax at all, but only to the normal tax? In other words, without stressing the arguments, all you can say is that while there may be at first a difference in price, where you have a progressively graduated tax the marginal buyer, the man on margin, is apt to be much nearer the 8% normal tax than the 58% surtax, so that the man who buys such a bond does not have to pay for the bond as much as he earned from exemption in taxation, and the inequality still remains.

But, finally, the argument which really prevailed in Washington a few days ago was the States right argument based upon the economic idea that if all these States and Municipalities ere made tax exempt you would have to pay so much more in the way of interest. Now to that again there are two answers. First, the scarcity privilege argument. If all bonds were tax exempt there would not be any premium at all, and in proportion, as the amount of these bonds is increasing by leaps and bounds--one and a half billions or two billions last year-- in proportion as the amount of these bonds is increasing this privilege will gradually disappear and many of you in this room tonight will see the premium entirely disappear before many years have passed. In fact, compare our municipals with those of Canada which are not tax exempt, and you will find there is very little difference in price even today. That argument has been much exaggerated. But the other point is this, even insofar as the City Government today can issue its bonds at a little lower rate of interest, it is a privilege which was never contemplated by our constitution. What our Constitution said and meant was that the National Government shall never impose a special or exclusive of differential tax upon the States or localities so as to put them at a disadvantage with other securities or with the National Government. But under the reciprocal provision which is provided for in this Constitutional amendment there is no such exclusive or differential imposition. What the States and localities enjoy today is a privilege which was never intended to be accorded to them, and which is gradually doing its work in breaking down the whole morale of the American people and gradually also causing to disappear the revenue of our income tax.

Gentlemen, I make this suggestion, that what we want in this country is real equality of taxation. What we want is equality between the rich and the poor. What we want is equality of treatment

as between the Federal Government and the State Government. What we do not want is either privilege of one kind or privilege of another kind, and the chief reason why I stand for the acceptance of the fundamental ideas of the Mellon Bill is because it seeks to achieve in a masterful way the equality to which we are all wedded. (Applause)