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REPORTS

OF THE

JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

SIXTY-NINTH CONGRESS

PURSUANT TO

SECTION 1203 (b) (6), REVENUE ACT OF 1926

DIVISION OF INVESTIGATION

VOL. 1—PART 1

TENTATIVE PLAN OF PROCEDURE

Printed for the use of the Members of the Committee

NOTE.—These reports have been submitted to the Chairman
and ordered printed by him, but have not yet been
approved by the full Committee



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TENTATIVE PLAN OF PROCEDURE

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON INTERNAL REVENUE TAXATION,
Washington, August 26, 1926.

To the Members of the Joint Committee on Internal-Revenue Taxation:

In order that you may be informed of the present status of the work being undertaken by the Joint Committee on Internal Revenue Taxation, of which you are a member, I wish to advise you as follows:

The revenue act of 1926, which authorized the joint committee, names as its first duty (sec. 1203 (c) (1)) "To investigate the operation and effects of the Federal system of internal-revenue taxes."

It appeared evident to me that in this work our division of investigation should first be employed to assemble those facts which the committee, or its tax simplification division, would require in order to deal intelligently with various subjects which we must consider.

In order to get a start on this work before the committee next convenes but to do so at a minimum of expense I have temporarily appointed Mr. L. H. Parker to the position of chief of the division of investigation. Mr. Parker has had long experience with this class of work and has the knowledge of the law and the technical training necessary to properly proceed with this work without loss of time. I have also appointed Mr. B. C. Brown as clerk and temporary secretary of the committee. As these are the only employees appointed, it can be seen that our expenses are very light.

I have had a general conference with Mr. Parker on the work of his division, and have instructed him to proceed along constructive lines. In order that you may have an idea just how we are starting on the work, I am attaching herewith a copy of Mr. Parker's report on "Tentative procedure, division of investigation," which is confirmatory of the conference we had on the subject.

When reports are available on specific subjects, I will forward copies of same to you. It will necessarily take some time to compile some of the reports on account of the voluminous nature of the statistics which must be examined.

It should be noted in regard to the subjects which have been suggested for investigation, that this does not necessarily mean that the law is unsatisfactory on these points. In fact, it may be just as important to have at hand the data which will prevent any ill-advised change in the existing law, as to assemble those facts which will lead to a beneficial revision.

I will always be glad of any suggestion or criticism you may desire to make.

Very truly yours,

WM. R. GREEN,
Chairman Joint Committee on Internal Revenue Taxation.

HON. WILLIAM R. GREEN,
*Chairman Joint Committee on
 Internal Revenue Taxation,
 Council Bluffs, Iowa.*

AUGUST 17, 1926.

MY DEAR CHAIRMAN: During our conferences of August 2 and 3 you outlined a preliminary policy to be followed by the division of investigation of the joint committee. Certain specific subjects which seemed worthy of investigation were also discussed. It appears wise to reduce the results of the conferences noted to writing, adding such additional matter as is necessary to outline a tentative plan of procedure for the division of investigation.

SCOPE OF THE WORK

The revenue act of 1926 specifies, under section 1203, subdivision (c) that it shall be the duty of the joint committee—

- (1) To investigate the operation and effects of the Federal system of internal-revenue taxes.
- (2) To investigate the administration of such taxes by the Bureau of Internal Revenue or any executive department, establishment, or agency charged with their administration.
- (3) To make such other investigations in respect of such system of taxes as the joint committee may deem necessary.

Other duties of the committee are enumerated in the same section, under subdivisions (c) (4), (c) (5), and (c) (6), but it is obvious that as far as the division of investigation is concerned its principal duty is described by the three subdivisions above quoted.

The revenue act of 1926 covers the law for the collection of internal revenue from several sources and therefore this act is divided into 12 titles. The most important division of the act for purposes of investigation is Title II, covering the income tax.

Title III covering the estate tax, Title VII covering the capital stock tax and Title XI covering general administrative provisions will also require study.

Until the joint committee next convenes, and in line with your policy, the division of investigation will confine its attention entirely to the investigation of the operation and effects of Title II, income tax.

This investigation will proceed entirely along constructive lines, the following subjects having tentatively been selected as requiring research and report:

REFERENCE NO.	SUBJECT
1	Depletion of mines.
2	Depletion of oil and gas wells.
3	Inventories.
4	Capital gains and losses.
5	Earned income.
6	Surtax.
7	Installment sales.
8	Depreciation.
9	Credits allowed individuals.
10	Evasion of surtaxes by incorporation.
11	Consolidated returns.
12	Publication of statistics.
13	Closing old tax returns.
14	Loss of revenue through gifts and trusts.
15	Foreign corporations.
16	Interest.
17	Valuation methods.
18	Board of tax appeals.

Attached to this report will be found a list of these tentative subjects for investigation more explicitly stated with certain explanatory notes, making clear the reason for investigating these matters.

SUBJECTS TO BE FIRST INVESTIGATED

For the first few months, as the writer is carrying on the work practically alone with such assistance as the bureau can furnish without inconvenience, it is probable that the facts on about five of the specific subjects already enumerated will be all that can be collected.

Even on these five subjects it may be necessary to make a preliminary report, to be followed later by a final report. The reason for this is that all the statistics to be compiled from the 1925 returns are not yet available.

The five subjects selected for immediate investigation follow:

REFERENCE NO.	SUBJECT
1.....	Depletion of mines.
2.....	Depletion of oil and gas wells.
8.....	Depreciation.
10.....	Evasion of surtaxes by incorporation.
11.....	Consolidated returns.

PRESENT STATUS OF THE WORK

Conferences have been held with the proper bureau officials which assures cooperation between the bureau and the agents of the joint committee.

To avoid duplication and expense, a survey has been made of the statistics available in the statistical section of the Income Tax Unit.

Work has been started on the investigation of depletion allowed on oil and gas wells (Reference No. 2), the effect of the arbitrary 27½ per cent allowed for depletion in the 1926 act being carefully studied.

Statistics are being compiled as to the depletion allowed some 400 representative oil-producing companies for the years 1924 and 1925. Not only the depletion but the gross income from oil sales, the profit from these sales, the net income, depreciation and the taxes paid by these companies are recorded. Thus, the percentage of depletion to gross income or to gross profit from sales can be shown for both the years 1924 and 1925, and the relative change in these percentages for the two years will be a practical index of the effect of the 27½ per cent allowance.

The same information is being compiled for a group of producing and refining oil companies, and for a group of holding companies which represent lessor interests.

The writer is studying the other four subjects to be investigated with a view of arriving at the best plan of gathering the necessary statistics. Work on at least two of these other subjects will be started shortly.

CONCLUSION

As the work proceeds along the specific lines mentioned, the writer is making notes of any additional matters which seem worthy of investigation, as well as any suggestions which may come to him from others.

In accordance with the above, we would be very glad to have your suggestions or the suggestions of other members of the committee as they may occur to you or to them from time to time.

Very respectfully,

L. H. PARKER,
Chief Division of Investigation.

TENTATIVE SUBJECTS FOR INVESTIGATION, REVENUE ACT OF 1926

TITLE II.—INCOME TAX

A. REPORTS ON SPECIFIC PROVISIONS

SUBJECT REPORT IN RE SECTION 204 (c) (1)

REFERENCE NO. 1.—DEPLETION OF MINES

The operation and effect of the depletion provision in regard to mines as allowed under section 204 (c) (1), with special reference to the rules being applied by the bureau in permitting discovery value.

NOTE.—The 1926 act in regard to the above has changed the 1924 act in that it specifically allows discovery values to be set up in known mines if a new vein of ore is discovered therein. The effect of this change on the taxes of this industry should be reported on in connection with the general subject.

SUBJECT REPORT IN RE SECTION 204 (c) (2)

REFERENCE NO. 2.—DEPLETION OF OIL AND GAS WELLS

The operation and effect of the depletion provision in regard to oil and gas wells as allowed under section 204 (c) (2), with special reference to the relief afforded by the arbitrary 27½ per cent of the gross income allowed as a depletion deduction.

NOTE.—The 1926 act in regard to depletion on oil and gas wells includes a radical change from the 1924 act, consisting of the substitution of an arbitrary 27½ per cent of gross income for a depletion deduction in lieu of the depletion, on discovery value previously allowed. It is most important to study the effect of this change as it was made on insufficient data.

SUBJECT REPORT IN RE SECTION 205

REFERENCE NO. 3.—INVENTORIES

Operation and effect of the inventory provision as provided under section 205, with special reference to the various rules laid down for pricing same by the bureau.

NOTE.—The basis of inventories and the pricing thereof above noted has been specifically assigned to the determination of the commissioner. It appears that the Congress should be informed of how this provision is being operated in order to see if greater explicitness in the law is desirable.

SUBJECT REPORT IN RE SECTION 208

REFERENCE NO. 4.—CAPITAL GAINS AND LOSSES

The operation and effect of the provision for taxing capital gains and losses, with special reference to the net result in income to the Government from this provision.

NOTE.—A partial study of the subject of capital gains and losses indicated that the total capital losses from 1917 to 1923, inclusive, exceeded the capital gains, thus causing a loss of revenue. In 1924 it appears the gains exceeded the losses. This study should be continued in order to consider the advisability of retaining this section of the act.

SUBJECT REPORT IN RE SECTION 209

REFERENCE NO. 5.—EARNED INCOME

The operation and effect of the earned income provision, in regard to the total deduction from tax allowed.

NOTE.—It appears that the taxpayers in general do not correctly interpret this provision, and an enormous amount of work is required of the bureau in rectifying the mistakes made. Data should be supplied for the simplification of this section, if possible.

SUBJECT REPORT IN RE SECTION 211

REFERENCE NO. 6.—SURTAX

The operation and effect of the surtax rates, with special regard to the effect on the various classes of income as classified by size.

NOTE.—Preliminary information indicates that the total revenue from surtaxes on the 1925 returns will be as great as, or even exceed, the revenue collected on 1924 returns from this source, in spite of the reduction in surtax rates. A special analysis should be made of the economic causes behind this result, in order that a prediction may be made as to the probable continuance of a like revenue from this source.

SUBJECT REPORT IN RE SECTION 212(D)

REFERENCE NO. 7.—INSTALLMENT SALES

The operation and effect of the provision governing the reporting of income from installment sales.

NOTE.—As this subdivision is new in the 1926 act, a report thereon is in point.

SUBJECT REPORT IN RE SECTIONS 214(A) (8) AND 234(A) (7)

REFERENCE NO. 8.—DEPRECIATION

The operation and effect of the provision allowing for the deduction of depreciation and obsolescence.

NOTE.—While this provision is the same as in the 1924 act, nevertheless, as the allowances for depreciation are probably the largest deductions from gross income, it is important to collect the statistics which will show the relief afforded various industries by this provision. The matter of establishing uniform and equitable rates in various industries and the publishing of same by the bureau should also receive consideration.

SUBJECT REPORT IN RE SECTION 216

REFERENCE NO. 9.—CREDITS ALLOWED INDIVIDUALS

The operation and effect of the credits allowed individuals, with special reference to the personal exemption and credits allowed for dependents.

NOTE.—The 1926 act increased the personal exemption of both single and married persons but retained the same credit for dependents as in the 1924 act. A report on the number of taxpayers relieved from income tax by the change is pertinent, together with general statistics on the average cost of dependents to a taxpayer.

SUBJECT REPORT IN RE SECTION 220

REFERENCE NO. 10.—EVASION OF SURTAXES BY INCORPORATION

The operation and effect of the provision to prevent the evasion of surtaxes by incorporation should be investigated.

NOTE.—It appears that this provision has rarely, if ever, been enforced by the bureau. It is therefore important to study this matter with the view of ascertaining if the intent of the act is being carried out and, if not, whether more explicitness in the law is required in order to make the provision enforceable.

SUBJECT REPORT IN RE SECTION 240

REFERENCE NO. 11.—CONSOLIDATED RETURNS

The operation and effect of the consolidated returns provision of the act, with special reference to the equity or inequity of same and the effect on the revenue collected from affiliated corporations.

NOTE.—The effect of the consolidated returns provision has never been completely studied. Some changes in wording have been made in the 1926 act, and a complete report on this matter is important.

SUBJECT REPORT IN RE SECTION 258

REFERENCE NO. 12.—PUBLICATION OF STATISTICS

A report on the publication of statistics by the Bureau of Internal Revenue, as provided under the above section, with the object of making same more suitable for the use of the Congress in its legislative studies.

NOTE.—A survey indicates that there are many statistics in regard to tax returns recorded by the bureau which are not published or assembled in such shape as to be useful for the study of specific features of the revenue act. A very small expense would make available to the Congress just the information required, not only in studying the effect of the present or future acts, but also would make available those facts necessary for the prediction of the next year's revenue.

B. REPORTS ON GENERAL SUBJECTS

SUBJECT REPORT ON INCOME TAX OR RELATED MATTERS

REFERENCE NO. 13.—CLOSING OLD TAX RETURNS

A report on the status of the work in the bureau in regard to old tax cases not yet closed out, with special reference to the causes therefor, and the consideration of those provisions of the law which may contribute to the delay in settling cases.

NOTE.—For a long time probably the most important thing in relation to income tax has been the problem of getting the bureau current in handling tax matters. While there may have been marked improvement in this matter recently, no reasonable step should be left undone in aiding in the accomplishment of this purpose. The most frequent criticism of the bureau by the public comes from this source, and no great economy can be effected in the bureau until the bureau is current in its work to a practical degree.

REFERENCE NO. 14.—LOSS OF REVENUE THROUGH GIFTS AND TRUSTS

A report on the extent of legal tax evasion through gifts and trusts as permitted under the present act.

NOTE.—The revenue act is based not only on the principle of taxing the annual income of an individual or corporation, but it also taxes, in general, the appreciation in property accruing over a period of years in the year in which such profit is realized. When gifts are made or trusts established it is possible, however, to legally evade the tax which would normally accrue to the Government on the sale or other disposition of the property.

A comparison of the taxes paid by John D. Rockefeller and John D. Rockefeller, jr., and by Henry Ford and Edsel Ford is sufficient to show that the loss in revenue from this exception is great. A study indicating the total loss in revenue from this exception to a tax on realized appreciation in property will be valuable.

REFERENCE NO. 15.—FOREIGN CORPORATIONS

A report on taxes paid by foreign corporations with the purpose of determining whether or not the true profit of these companies made in the United States does not often escape taxation.

NOTE.—The bureau is at great disadvantage in determining the proper tax on many foreign corporations, whose controlling records are kept in other countries. The writer has in mind, for instance, a certain foreign corporation which did an annual gross business in this country in excess of \$400,000,000 a year for a number of years, and yet during that period paid practically no tax, on account of claiming either no profit or loss. It would seem important to study this subject, and also to coordinate the cost of goods imported into the country as shown on income-tax returns with the declared value for customs purposes. The result of such an investigation might recover a considerable tax either through customs or income tax.

REFERENCE NO. 16.—INTEREST

A report on the interest provision of the revenue act, with special reference to how these provisions are administered and how they affect the Government and the taxpayer.

NOTE.—A clear and explicit statement of how the interest provisions are interpreted is important as there has been some confusion in this matter.

REFERENCE NO. 17.—VALUATION METHODS

A comparative report on the valuation methods employed by the Income Tax Unit and the estate-tax division, with the purpose of producing uniformity in the methods of these two divisions.

NOTE.—In the interest of equity, it is apparent that valuation of property for either estate-tax or income-tax purposes should be coordinated, and similar methods employed.

REFERENCE NO. 18.—BOARD OF TAX APPEALS

An administrative report showing what the bureau is doing to keep trivial cases from going to the Board of Tax Appeals with suggestions for a still further organization in the bureau to cut down the number of cases going before the board.

NOTE.—While the Board of Tax Appeals is hearing and disposing of cases in a very creditable manner, it is obviously important to keep the number of cases going before the board down to a reasonable number. Cases which could be settled by a little careful consideration between the bureau and the taxpayer should be so handled.