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PUBLIC SALARY TAX ACT OF 1939

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

SEVENTY-SIXTH CONGRESS

FIRST SESSION

ON

H. R. 3790

**AN ACT RELATING TO THE TAXATION OF THE COMPENSATION
OF PUBLIC OFFICERS AND EMPLOYEES**

—————
FEBRUARY 21, 1939
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Printed for the use of the Committee on Finance



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PUBLIC SALARY TAX ACT, 1939

TUESDAY, FEBRUARY 21, 1939

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.,

The committee met, pursuant to call, at 10 a. m., in room 212, Senate Office Building, Senator Pat Harrison presiding.

The CHAIRMAN. The committee will be in order. The committee has met this morning primarily for the purpose of considering H. R. 3790, a bill with reference to reciprocal taxation of the compensation of State and Federal employees.

I desire to submit for the record a copy of H. R. 3790, as well as copies of the messages of the President, dated April 25, 1938, and January 19, 1939.

(The bill and Presidential messages are as follows:)

[H. R. 3790, 76th Cong., 1st sess.]

AN ACT Relating to the taxation of the compensation of public officers and employees

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Public Salary Tax Act of 1939".

TITLE I

SECTION 1. (a) Section 22 (a) of the Revenue Act of 1938 (relating to the definition of "gross income") is amended by inserting after the words "compensation for personal service" the following: "(including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing)".

(b) The amendment made by this section shall apply only to taxable years beginning after December 31, 1938.

Sec. 2. Section 116 (b) of the Revenue Act of 1938 (exempting compensation of teachers in Alaska and Hawaii from income tax) shall not apply to any taxable year beginning after December 31, 1938.

Sec. 3. The United States hereby consents to the taxation of compensation, received after December 31, 1938, for personal service as an officer or employee of the United States, any Territory or possession or political subdivision thereof, the District of Columbia, or any agency or instrumentality of any one or more of the foregoing, by any duly constituted taxing authority having jurisdiction to tax such compensation, if such taxation does not discriminate against such officer or employee because of the source of such compensation.

TITLE II

SEC. 201. Any amount of income tax (including interest, additions to tax, and additional amounts) for any taxable year beginning prior to January 1, 1938, to the extent attributable to compensation for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality or any one or more of the foregoing—

(a) shall not be assessed, and no proceeding in court for the collection thereof shall be begun or prosecuted (unless pursuant to an assessment made prior to January 1, 1939);

(b) if assessed after December 31, 1938, the assessment shall be abated, and any amount collected in pursuance of such assessment shall be credited or refunded in the same manner as in the case of an income tax erroneously collected; and

(c) shall, if collected on or before the date of the enactment of this Act, be credited or refunded in the same manner as in the case of an income tax erroneously collected, in the following cases—

(1) Where a claim for refund of such amount was filed before January 10, 1939, and was not disallowed on or before the date of the enactment of this Act;

(2) Where such claim was so filed but has been disallowed and the time for beginning suit with respect thereto has not expired on the date of the enactment of this Act;

(3) Where a suit for the recovery of such amount is pending on the date of the enactment of this Act; and

(4) Where a petition to the Board of Tax Appeals has been filed with respect to such amount and the Board's decision has not become final before the date of the enactment of this Act.

Sec. 202. In the case of any taxable year beginning after December 31, 1937, and before January 1, 1939, compensation for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing, shall not be included in the gross income of any individual under Title I of the Revenue Act of 1938 and shall be exempt from taxation under such title, if such individual either—

(a) did not include in his return for a taxable year beginning after December 31, 1936, and before January 1, 1938, any amount as compensation for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing; or

(b) did include any such amount in such return, but is entitled under section 201 of this Act to have the tax attributable thereto credited or refunded.

Sec. 203. Any amount of income tax (including interest, additions to tax, and additional amounts) collected on, before, or after the date of the enactment of this Act for any taxable year beginning prior to January 1, 1939, to the extent attributable to compensation for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing, shall be credited or refunded in the same manner as in the case of an income tax erroneously collected, if claim for refund with respect thereto is filed after January 18, 1939, and the Commissioner of Internal Revenue, under regulations prescribed by him with the approval of the Secretary of the Treasury, finds that disallowance of such claim would result in the application of the doctrines in the case of *Helvering against Gerhardt* (304 U. S. 405) extending the classes of officers and employees subject to Federal taxation.

Sec. 204. Neither section 201 nor section 203 shall apply in any case where the claim for refund, or the institution of the suit, or the filing of the petition with the Board, was, at the time filed or begun, barred by the statute of limitations properly applicable thereto.

Sec. 205. Compensation shall not be considered as compensation within the meaning of sections 201, 202, and 203 to the extent that it is paid directly or indirectly by the United States or any agency or instrumentality thereof.

Sec. 206. The terms used in this Act shall have the same meaning as when used in Title I of the Revenue Act of 1938.

Sec. 207. If either title of this Act, or the application thereof to any person or circumstances, is held invalid, the other title of the Act shall not be affected thereby.

Passed the House of Representatives February 9, 1939.

Attest:

SOUTH TRIMBLE,

Clerk.

By H. NEWLIN MCGILL.

MESSAGE FROM THE PRESIDENT OF THE UNITED STATES, TRANSMITTING HEREWITH A RECOMMENDATION FOR APPROPRIATE LEGISLATION ENDING TAX EXEMPTION ON GOVERNMENT SALARIES OF ALL KINDS, CONFERRING POWERS ON THE STATES WITH RESPECT TO FEDERAL SALARIES AND POWERS TO THE FEDERAL GOVERNMENT WITH RESPECT TO STATE AND LOCAL GOVERNMENT SALARIES

THE WHITE HOUSE,
April 25, 1938.

To the Congress of the United States:

The sixteenth amendment to the Constitution of the United States, approved in 1913, expressly authorized the Congress "to lay and collect taxes on incomes, from whatever source derived." That is plain language. Fairly construed, this language would seem to authorize taxation of income derived from State and municipal, as well as Federal bonds, and also income derived from State and municipal as well as Federal offices.

This seemingly obvious construction of the sixteenth amendment, however, was not followed in judicial decisions by the courts. Instead, a policy of reciprocal tax immunity was read into the sixteenth amendment. This resulted in exempting the income from Federal bonds from State taxation and exempting the income from State bonds from Federal taxation.

Whatever advantages this reciprocal immunity may have had in the early days of this Nation have long ago disappeared. Today it has created a vast reservoir of tax-exempt securities in the hands of the very persons who equitably should not be relieved of taxes on their income. This reservoir now constitutes a serious menace to the fiscal systems of both the States and the Nation because for years both the Federal Government and the States have come to rely increasingly upon graduated income taxes for their revenues.

Both the States and the Nation are deprived of revenues which could be raised from those best able to supply them. Neither the Federal Government nor the States receive any adequate, compensating advantage for the reciprocal tax-immunity accorded to income derived from their respective obligations and offices.

A similar problem is created by the exemption from State or Federal taxation of a great army of State and Federal officers and employees. The number of persons on the pay rolls of both State and Federal Government has increased in recent years. Tax exemptions claimed by such officers and employees—once an inequity of relatively slight importance—has become a most serious defect in the fiscal systems of the States and the Nation, for they rely increasingly upon graduated income taxes for their revenues.

It is difficult to defend today the continuation of either of these rapidly expanding areas of tax exemption. Fundamentally our tax laws are intended to apply to all citizens equally. That does not mean that the same rate of income tax should apply to the very rich man and to the very poor man. Long ago the United States, through the Congress, accepted the principle that citizens should pay in accordance with their ability to pay, and that identical tax rates on the rich and on the poor actually worked an injustice to the poor. Hence, the origin of progressive surtaxes on personal income as the individual personal income increases.

Tax exemptions through the ownership of Government securities of many kinds—Federal, State, and local—have operated against the fair or effective collection of progressive surtaxes. Indeed, I think it is fair to say that these exemptions have violated the spirit of the tax law itself by actually giving a greater advantage to those with large incomes than to those with small incomes.

Men with great means best able to assume business risks have been encouraged to lock up substantial portions of their funds in tax-exempt securities. Men with little means who should be encouraged to hold the secure obligations of the Federal and State Governments have been obliged to pay a relatively higher price for those securities than the very rich because the tax-immunity is of much less value to them than to those whose incomes fall in the higher brackets.

For more than 20 years Secretaries of the Treasury have reported to the Congress the growing evils of these tax exemptions. Economists generally have regarded them as wholly inconsistent with any rational system of progressive taxation.

Therefore, I lay before the Congress the statement that a fair and effective progressive income tax and a huge perpetual reserve of tax-exempt bonds cannot exist side by side.

The desirability of this recommendation has been apparent for some time, but heretofore it has been assumed that the Congress was obliged to wait upon that cumbersome and uncertain remedy—a constitutional amendment—before taking action. Today, however, expressions in recent judicial opinions lead us to hope that the assumptions underlying these doctrines are being questioned by the court itself and that these tax immunities are not inexorable requirements under the Constitution itself but are the result of judicial decision. Therefore, it is not unreasonable to hope that judicial decision may find it possible to correct it. The doctrine was originally evolved out of a totally different set of economic circumstances from those which now exist. It is a familiar principle of law that decisions lose their binding force when the reasons supporting them no longer are pertinent.

I, therefore, recommend to the Congress that effective action be promptly taken to terminate these tax exemptions for the future. The legislation should confer the same powers on the States with respect to the taxation of Federal bonds hereafter issued as is granted to the Federal Government with respect to State and municipal bonds hereafter issued.

The same principles of just taxation apply to tax exemptions of official salaries. The Federal Government does not now levy income taxes on the hundreds of thousands of State, county, and municipal employees. Nor do the States, under existing decisions, levy income taxes on the salaries of the hundreds of thousands of Federal employees. Justice in a great democracy should treat those who earn their livelihood from government in the same way as it treats those who earn their livelihood in private employ.

I recommend, therefore, that the Congress enact legislation ending tax exemption on Government salaries of all kinds, conferring powers on the States with respect to Federal salaries and powers to the Federal Government with respect to State and local government salaries.

Such legislation can, I believe, be enacted by a short and simple statute. It would subject all future State and local bonds to existing Federal taxes; and it would confer similar powers on States in relation to future Federal issues.

At the same time, such a statute would subject State and local employees to existing Federal income taxes and confer on the States the equivalent power to tax the salaries of Federal employees.

The ending of tax exemption, be it of Government securities or of Government salaries, is a matter, not of politics, but of principle.

FRANKLIN D. ROOSEVELT.

MESSAGE FROM THE PRESIDENT OF THE UNITED STATES TRANSMITTING A RECOMMENDATION FOR LEGISLATION TO CORRECT INEQUITIES EXISTING IN THE PRESENT TAX LAWS

To the Congress of the United States:

In my message of April 25, 1938, I urged that the time had come when the Congress should exercise its constitutional power to tax income from whatever source derived. I urged that the time had come when private income should not be exempt either from Federal or State income tax simply because such private income is derived as interest from Federal, State, or municipal obligations, or because it is received as compensation for services rendered to the Federal, State, or municipal governments.

A fair and effective progressive income tax and a huge perpetual reserve of tax-exempt bonds could not exist side by side. Those who earn their livelihood from government should bear the same tax burden as those who earn their livelihood in private employment.

The tax immunities heretofore accorded to private income derived from Government securities or government employment are not inexorable requirements of the Constitution, but are the result of judicial decision. I repeat that it is not unreasonable to hope that judicial decision would permit the elimination of these immunities.

Decisions of the Supreme Court rendered since my message, particularly the decision in the *Port of New York Authority case*, have made an important and constructive contribution to the elimination of these inequitable immunities.

It is obvious, however, that these inequities cannot be satisfactorily corrected by judicial decisions alone. Without legislation to supplement them, many individuals and corporations will be subjected to tax liabilities for income received in past years which they mistakenly, but in good faith, believed to be tax-exempt. It is evident, for example, that employees of many State agencies, as well as the holders of securities of public corporations, believed that the income they received from such sources was tax-exempt, in view of the opinions of eminent counsel based upon earlier decisions of the Supreme Court. In the interest of equity and justice, therefore, immediate legislation is required to prevent recent judicial decisions from operating in such a retroactive fashion as to impose tax liability on these innocent employees and investors for salaries heretofore earned, or on income derived from securities heretofore issued.

In the light of those decisions there are, among the taxpayers of the Nation, inevitable uncertainties respecting their tax liabilities. There is uncertainty whether the salaries which they receive are not taxable under the existing provisions of the revenue acts; there is uncertainty whether the interest which they receive upon the obligations of governmental instrumentalities is similarly not taxable; and there is an uncertainty whether the salaries and interest which they have received for past years will create an unanticipated source of tax liabilities and penalties.

In view of the fact that the Bureau of Internal Revenue will have no choice but to enforce our income-tax law as declared in the latest decisions of the Supreme Court, prompt legislation is necessary to safeguard against the inequities to which I have referred. The need, therefore, is for the prompt enactment of equitable rules, prospective in operation, which the Bureau can apply and taxpayers can observe without that mass of litigation which otherwise is to be anticipated. We are confronted with a situation which can be handled with fairness to all and with reasonable administrative convenience only through the cooperation of the Congress and the courts.

Unless the Congress passes some legislation dealing with this situation prior to March 15th, I am informed by the Secretary of the Treasury that he will be obliged to collect back taxes for at least 3 years upon the employees of many State agencies and upon the security holders of many State corporate instrumentalities, who mistakenly but in good faith believed they were tax exempt. The assessment and collection of these taxes will doubtlessly in many cases produce great hardship.

Accordingly, I recommend legislation to correct the existing inequitable situation, and at the same time to make private income from all Government salaries hereafter earned and from all Government securities hereafter issued subject to the general income-tax laws of the Nation and of the several States. It is difficult for almost all citizens to understand why a constitutional provision permitting taxes on "income from whatever source derived" does not mean "from whatever source derived."

FRANKLIN D. ROOSEVELT.

THE WHITE HOUSE,
January 19, 1939.

The CHAIRMAN. During the last session of Congress a special committee was appointed by the Senate to study the question of taxing the income from tax-exempt securities and also the question of reciprocal taxation of governmental salaries. Senator Brown is chairman of that committee. I think we ought to hear the report of that committee respecting the salary tax question, if they are ready to make a report.

**STATEMENT OF HON. PRENTISS M. BROWN, UNITED STATES
SENATOR FROM MICHIGAN**

Senator BROWN. Mr. Chairman, and members of the committee: We were appointed by the Senate in June of last year to make a report to the Senate upon the question of income taxation of State

salaries by the Federal Government and a reciprocal taxation of Federal salaries by the State governments, and likewise as to the income on bonds.

This question has been before the people of the United States since the Civil War days. The first attempt to tax the salaries of the State government occurred in 1862. There were five or six acts passed during the Civil War period, and again an act was passed in 1894. From that time down to the present there has been no important legislation.

This subject has been extensively investigated very recently. I want to call the attention of the members of the committee, if they desire to make a special study of it in the next few days, to the fact that we have at least four publications that go fully into the economic and legal aspects of the question. There is, first, the work by the Department of Justice, which was referred to in our hearings as the "White Book," and which is entitled "Taxation of Government Bondholders and Employees—the Immunity Rule and the Sixteenth Amendment." It is a very exhaustive and thorough piece of work. The opposition brief, on the legal side, is entitled "The Constitutional Immunity of State and Municipal Securities," and was gotten up under the leadership of the solicitor general of New York, Mr. Henry Epstein, and Mr. Austin J. Tobin, who is secretary of the Conference on State Defense, organized by the State attorneys general, also a very able and exhaustive work.

Senator KING. They speak for a large number of States?

Senator BROWN. Yes; they speak for 39 States, as I recall. Is that right, Mr. Tobin?

Mr. TOBIN. Over 40.

Senator BROWN. Over 40. The testimony given was that there was just one State, Colorado, that refused to join in this brief, and there were four or five that gave noncommittal replies.

Then there is the very excellent report by the counsel for the joint committee on internal revenue taxation, which gives a review of the cases, the rules and statutes. It is 48 pages long and is the work of Mr. Stam and his staff.

It happens that students of the former Under Secretary of the Treasury, Mr. Magill, presented this question in a moot court in Columbia University, and there are two very excellent briefs on the constitutional questions involved, and it has been very informative to me.

In addition, there is the testimony of Treasury representatives and of Dr. Lutz, of Princeton University, and many others on the economic phase of the question.

Senator KING. Senator, would it be improper to state that Mr. Stam and his associates, who guide and direct this committee in their interpretation of the statutes, decided that this act was not valid?

Senator BROWN. Yes; that is true. I would say, and I think that Mr. Stam would agree with me, that "advise" would be a better word than either "guide" or "direct."

The CHAIRMAN. Let me ask you, Senator, in your investigation, and in connection with these briefs that have been presented, do they deal for the most part with the question of taxing the income from State and local securities or on the question of salaries?

Senator BROWN. The legal arguments made by the Department of Justice and in the Columbia University study, which was under the direction of Mr. Magill, go into both questions. The work of Mr. Stam goes into both questions. The State attorneys generally mention salaries briefly. I think they devote about a page and a half to that question, and while they take the view that the taxation as proposed is probably unconstitutional, they do not stress that proposition at all. They did not exhibit a great deal of interest in the salary question. The purpose of their organization is to oppose the proposal to tax municipal and State securities. Is that right, Mr. Tobin?

Mr. Tobin is the secretary of the conference.

Mr. TOMX. That is right.

Senator BROWN. Now, I am open to questions of any kind from any member of the committee. I do not suppose I will be able to answer all questions that will be put to me, but naturally I could not hear several days of testimony, 1,200 pages, without getting a little knowledge on the question.

Our committee, Mr. Chairman, did not complete its hearings until last Thursday, and while I had presented to me two excellent written reports on the salary-tax question, one which Mr. Stam prepared according to the ideas of the committee, and one which the Department of Justice prepared for us, I do not feel, in view of the short time we had to discuss the problem, that I ought to present either one of those written reports, but I think I can state briefly the views of the committee, and I can endeavor to distinguish the salary tax from the bond income tax question from a legal standpoint.

I may say first, that all of us, except Senator Austin, who was unable to be here because of his engrossment in the affairs of the Military Affairs Committee, that is, Senator Byrd, Senator Logan, Senator Townsend, Senator Miller, and myself, conclude that from the economic standpoint salaries of Federal employees should be subject to State taxation, and we believe that salaries of State and local employees should be subject to Federal income taxation.

There are about 2,600,000 State and municipal employees in the United States. They draw, in round figures, \$3,600,000,000 a year. There are 1,200,000 Federal employees as of 1937. They draw about \$1,900,000,000 a year. The total of both is in number of employees 3,800,000; that is all government employees in the United States. These are the figures which Under Secretary Hanes of the Treasury Department submitted.

Senator DAVIS. Do these figures include the Army and Navy?

Senator BROWN. Yes; I think so. Do they, Mr. Hanes?

Mr. HANES (Undersecretary of the Treasury). Yes, sir.

Senator BROWN. They draw, in round figures, \$5,500,000,000. On a percentage basis that represents, that is all Government employees, 12 percent of all of the people of the United States who draw salaries or get wages, and the total amount, \$5,500,000,000, is about 13 percent of the total amount of compensation on the basis of salaries and wages. That represents about 9 percent of the total national income. So you can draw the conclusion that the average of Government, meaning by that both State and Federal Government, is a little higher than the average of wages and salaries of other employees, consider-

ing all income, 9 percent of all income and 13 percent of all salaries and wages.

The great majority of State and Federal employees draw less than \$2,500, and a very large percentage of course less than the \$1,500 exemption. So that actually a very large proportion—and that will be submitted as part of my remarks—a very large proportion of State and Federal employees will be unaffected by the present income-tax law.

(Senator Brown presented the following table, prepared by the Treasury Department:)

Salary classes	Number of officers and employees	Percent distribution of number	Amount of compensation (in thousands of dollars)
\$1,000 and under.....	1,036, 108	39. 72	528, 626
\$1,001 to \$1,500.....	644, 770	20. 69	636, 519
\$1,501 to \$2,000.....	439, 140	16. 84	772, 074
\$2,001 to \$2,500.....	323, 707	12. 41	731, 846
\$2,501 to \$3,000.....	135, 731	5. 20	374, 647
\$3,001 to \$3,500.....	53, 395	2. 05	174, 076
\$3,501 to \$4,000.....	33, 261	1. 23	125, 068
\$4,001 to \$4,500.....	18, 527	. 71	78, 539
\$4,501 to \$5,000.....	7, 354	. 28	35, 007
\$5,001 to \$6,000.....	7, 231	. 28	39, 841
\$6,001 to \$7,000.....	3, 313	. 13	21, 568
\$7,001 to \$8,000.....	2, 174	. 08	16, 327
\$8,001 to \$9,000.....	1, 242	. 05	10, 579
\$9,001 to \$10,000.....	907	. 03	8, 626
Over \$10,000.....	1, 339	. 05	18, 422
Total.....	2, 608, 289	100. 00	3, 623, 037

The total revenue involved is not great. There was no estimate made by anyone, as I recall, of the total amount of money that would be received by the States, because there are 33 States, I think, that have income-tax laws and it is very difficult to calculate the effect on the Federal officials of the various State income-tax laws.

It is estimated that the revenue to the Federal Government, which is much easier to calculate, would be about \$16,000,000. It is understood I am talking about salaries and not about income on bonds.

I digress to say that the estimate on the bonds is that the revenue to the Federal Government, when the full effect of State, local, and Federal bond income tax laws is felt, which is some 40 or 50 years off, will be about \$350,000,000 per year. But, of course, that would be only gradually felt, because there is no one, so far as I know, who has advocated retroactive taxation either as to salaries or as to bonds. The administration proposal is entirely prospective in effect.

The main justification for this tax on salaries, of course, lies in the fact that it is unjust to lay a burden on one class of wage earning, salary earning citizens and not lay a tax upon another. Everyone who sits where we do, and in the Congress of the United States, knows there is a great deal of criticism of public officials because they are, in part, exempt from taxation.

I digress here and say that it is amazing how many people throughout the country believe the Members of Congress and various officials of the Federal Government are exempt from the Federal income tax. It is very widely held. Of course, we know it is not true, and it is brought vividly to us on the 15th day of each March. But there is

just criticism, I think, on the part of the people generally because of the fact that we do not pay our share of State income taxes, and of course State officials are criticized in the same way. Therefore, the justification is not one of revenue, but it is one of justice as between taxpayers.

Unless there is something further on the economic aspect, and I am open to question at any time, I will briefly point out the legal situation to differentiate the the bond income proposal from the salary proposal.

Senator DAVIS. Did the committee study the pay of the Government and the State officials compared with private pay for doing work of a similar nature?

Senator BROWN. The only answer I can give to that is that the average wage of Government employees is slightly higher than that of those in private employment. The total income in the United States of Government officials and Government employees is 18 percent of the salary and wage income of the United States while they form 12 percent of the total drawing wages and salaries.

Senator DAVIS. That is the Federal and the State officials combined?

Senator BROWN. The State and Federal officials combined. I may say that the salary of Federal officials is slightly higher, on the average, than the pay of State and municipal officials, and I include cities and towns in that estimate.

Senator KING. Senator, was there a chart presented which indicated that the amount collected by the Federal Government on the salary tax and the amount collected by the State Governments would practically one balance the other?

Senator BROWN. I do not think so, Senator King. I think you are referring to Dr. Lutz's chart. Dr. Lutz's chart was upon the bond proposition and not upon the salary proposition. We had no figures upon that subject. Of course, the fact that there are many more State employees than there are Federal employees would probably lead to the result that you suggest in your question.

Now, if there is nothing further on that question, I will briefly discuss the legal aspect of this matter as our committee sees it.

The question of the legality of a tax on State salaries divides itself into two parts. May it be done under the present constitutional provisions, or must we have a constitutional amendment?

I lay aside entirely the question of constitutional amendment, because the present bill implies that a constitutional amendment is not needed to do what we seek to do, and that question divides itself into two parts, one which is tied in with the bond proposition and one which differentiates the salary tax from the tax on State securities.

The immunity doctrine stems from *McCulloch v. Maryland* (4 Wheat. 316), with which most lawyers are quite familiar. There was no particular section of the Constitution, nothing in the 10 amendments in effect at that time, which gave rise to Justice Marshall's views in the *McCulloch case*. He based his views upon a general structure of the Government of the United States. In a case in which the Legislature of Maryland attempted to impose a discriminatory tax upon the operations of a branch of the Bank of the United States in Baltimore he found that the act of the Maryland Legislature was unconstitutional and void. Many lawyers have pointed out since that

the decision could well have been grounded upon the discrimination. In other words, this heavy tax, which amounted to, I believe, \$13,000, on each branch of the Bank of the United States, or, in the alternative, a tax upon the paper which was used for the bank's notes, that the decision could have been based on the proposition that there was no similar tax against the banks chartered by the State of Maryland, and therefore that it was grossly discriminatory. But Justice Marshall did not base the decision upon that proposition; he based it upon the broad matter of the power of a State legislature to interfere with the operations of a creature of the Government of the United States, and laid down the well-known rule, which has been followed quite consistently since, that no State could interfere with the exercise of the sovereignty of the National Government.

The question next arose in *Dobbins v. Commissioners of Erie County* (16 Pet. 435). Dobbins was the captain of a revenue cutter of the United States operating on Lake Erie. Erie County attempted to lay a tax upon his salary. The Supreme Court, following the rule in *McCulloch v. Maryland*, held that the State could not interfere with an essential governmental function of the Federal Government through the taxing of a salary of an official of the United States. That case was before the Civil War.

It was followed by *Collector v. Day* (11 Wall 113), which is the chief impediment to this legislation. *Collector v. Day* was a case arising in Massachusetts and involved the salary of Judge Day, who was a probate judge in Barnstable County. The tax, as is usual in most of these constitutional cases, was inconsequential. It was based on the Civil War Act, the first one and second one, 1861 and 1862, as I recall it, and, briefly, the court held in line with the *Dobbins case* that the salary of the State judge was exempt from Federal taxation, and following *McCulloch v. Maryland* and *Dobbins v. Commissioners of Erie County*, the general rule, although there is some criticism on the proposition, some suggestion that it was based upon other considerations, nevertheless the court reaches the conclusion that it was based upon the same principle as *McCulloch v. Maryland*. It held that a Federal income tax on a State judge's salary was an infringement upon the rights of the State and an interference with an essential governmental function.

There has since been no case upon the express point. I say that in this sense: We have had many cases involving various types of governmental officials, ending up with a case with which everyone is familiar, the *Gerhardt case* (304 U. S. 405), and a case which I will mention a little bit later, but there has been, since *Collector v. Day*, no attempt on the part of the Federal Government to tax the salary of a State official who is engaged in an essential governmental function.

Evans v. Gore (253 U. S. 245) is the next case, and it involved a Federal income tax on a Federal judge. Gore was the collector and Evans was the judge in the Western District of Kentucky, and the Congress attempted to lay a tax upon the salary of this Federal judge. That is the first case that occurred after the passage of the sixteenth amendment, but I want to discuss it briefly without regard to the sixteenth amendment. The Court held, and the judgment of the court as distinguished from its opinion was made upon the proposition that the Constitution, the original Constitution, article III, sec-

tion 1, prohibited diminution of the judge's salary during his continuance in office. *Evans v. Gore* was grounded and decided upon that proposition, but the court went on to discuss the sixteenth amendment and held, in effect, that even if it were not for the provision of the Constitution itself, the sixteenth amendment would not justify the taxation of the salary of Judge Evans. I will refer to that when I get into the discussion of the sixteenth amendment.

If there is any question by any member of the committee on any of the numerous other pertinent cases, I have them all here, I am familiar with the facts in some of them, I will be glad to answer any questions, and if I haven't the facts, I can readily get them for you.

Senator KING. In the numerous decisions of the Supreme Court, since the case of *Collector v. Day*, there has been no attempt to overrule the decision in that case, has there, or to impair the integrity of the arguments presented in support of the conclusion reached by the Court?

Senator BROWN. Well, it is difficult, Senator King, to give you an answer to that question, because there has been—and I use “chiseling” in the proper sense of the term—there has been a chiseling away of the State immunity in a great many cases, ending with the decision in the *Gerhardt case*, which was quite astonishing to the legal profession generally. I intend to discuss that a little later. I will say this, that under the strict rule of *Collector v. Day*, unless the sixteenth amendment has overcome it—and that is the proposition I am about to discuss—there has been no reversal by the Supreme Court of the United States of the position that was taken in *Collector v. Day* as to an officer performing an essential governmental function as distinguished from those who do not perform such functions.

The sixteenth amendment, of course, gives rise to a major part of this controversy. I may say that the counsel for the joint committee disagrees with the views that I am about to state upon this proposition, and these views are mine, not necessarily those of the special committee. I am in agreement with the views to an extent that the Department of Justice expounds in its White Book and in disagreement with the views that are expounded by the States' attorneys general in what is known as the Yellow Book. There are a great many different angles to this question. It is impossible to give an exhaustive statement concerning it in a short time, but I can briefly touch the high spots and particularly the propositions that appeal to me.

The controversy out of which arose the sixteenth amendment had its roots in the Civil War period. I think any construction that is given to the sixteenth amendment must necessarily take a view of what was said in the Civil War acts as well as the act of 1894.

Briefly to review. The first Federal income tax of which I have any knowledge, came in the Civil War period. I think there were four, five, six, or seven of them—it is not particularly important. After the decision in *Collector v. Day*, which came in 1870 or 1871, and after the necessity for an income tax passed, because of the ending of the war and clearing up of the war debt, we had no further income tax legislation until 1894, when the act was passed out of which arose the famous *Pollock cases* (157 U. S. 429; 158 U. S. 601); two cases, and those, along with the Civil War acts, will be a subject of my discussion.

As everyone knows, the controversy over the sixteenth amendment revolved around the meaning of the words in the amendment itself, "from whatever source derived." I will read the amendment to bring it back to mind.

The Congress shall have power to lay and collect taxes on incomes from whatever source derived without apportionment among the several States and without regard to any census or enumeration.

The provisions of the Constitution upon which rested the right to lay an income tax are in sections 8 and 9 of the original Constitution, which are as follows:

The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States;

No capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken.

The meaning of the phrase "from whatever source derived" gives rise to the entire controversy. I think it should here be said that if the various expressions of the Supreme Court by way of dicta in many cases since 1910, in which the sixteenth amendment was involved, are to be taken as the view of the court, there is no question in my mind but that the court would find this particular act unconstitutional.

I think I should immediately follow that statement by saying that the precise question involved has never been before the Supreme Court, unless it be said that it was there in *Evans v. Gore* and in *Brush v. Commissioner* (300 U. S. 352), and in those cases, particularly in *Evans v. Gore*, the Government conceded that the sixteenth amendment did not justify the tax involved. In other words, while the court went on and discussed the effect of the sixteenth amendment on Judge Evans' salary, nevertheless the Government conceded that the sixteenth amendment did not justify the tax. So it cannot be said that there has been a clear ruling upon the precise question involved, because the Government, as then represented, conceded the position, which, as now represented, they deny. The citizens of the United States are not to be bound, in my judgment, by a concession on the part of any particular administration or any particular attorney general nor by a court opinion where the point involved was conceded.

The same can be said of any of the other cases involved. I think no one contends that the precise question here involved has ever been squarely presented to the Supreme Court of the United States, but in various statements they have made they have intimated quite strongly that they believe that the sixteenth amendment did not add anything to the power of Congress to tax, that it merely eliminated the necessity for apportionment.

Senator KING. Senator, in the *Brushaber* case (240 U. S. 1), the court had before it squarely the sixteenth amendment, and there were arguments pro and con during the consideration of that case, and the court made the statement which in effect declared that the sixteenth amendment did not authorize the imposition of an income tax.

Senator BROWN. I think, Senator, that I would agree with you that the court had so stated, but I do say that the precise question was not before the court. The case went off on another point, just as *Evans v. Gore* went off on another point.

I want to say here that I am not in these rather intricate questions, expressing the views of all the members of my committee, I am giving my own views, but on the desirability of this bill we are in agreement.

Now getting back to the meaning of the phrase "from whatever source derived," there has never been presented to the Supreme Court, so I am informed by various attorneys, the full history of the sixteenth amendment, its enactment and the legislative history back of it. At least the matters which I am about to discuss, which are quite fully discussed in the Columbia University briefs and in the Department of Justice White Book, have not been presented to the Court.

All of the Civil War acts purported to tax the income of State officials and of Federal officials, otherwise *Collector v. Day* would not have arisen. The income tax laws of 1864, 1865, 1866, and 1867 taxed income derived from certain named sources and "from any other source whatever."

That is the important phrase in my judgment. Each one of the subsequent acts contained that identical language, "from any other source whatever." You see, that has close similarity to the phrase in the sixteenth amendment, "from whatever source derived."

It is important to note that after *Collector v. Day* was decided based upon the Civil War acts, that the Congress, in the 1894 act, used this same language, "from any source whatever" but expressly exempted in plain language the salaries of State officials in deference to *Collector v. Day*, but the justification for the levy of a tax upon municipal bonds, and other State bonds, arose, in my judgment, out of the phrase in the 1894 act which said, "income from any other source whatever."

As is well known, the *Pollock cases* arose out of the 1894 act. The arguments were many and diverse. The Court was unanimous in its views on the principal question involved, which affects us today. There was a decision of 5 to 4 upon the other question, but that is not of particular importance here.

Pollock was a stockholder in the Farmers Loan & Trust Co. of New York, and when the Federal Government sought to levy a tax upon the income of the trust company, Pollock, as a stockholder, asked an injunction restraining the collector from collecting this tax, or it may possibly have been restraining the trust company itself from paying the tax, I have forgotten which, but it presented exactly the same question. That case came here and was decided in 1895 or 1896, along in there. It was here twice: Once because there were only eight justices, and they were equally divided upon one of the important features of the case. The essential holding is this: All nine judges found unanimously that the tax laid a burden upon municipal bond interest because the income of the trust company was made up, in part, of the interest upon New York City bonds, I think \$60,000 out of a larger total, and since they were mixed and the tax charged against all of it, the entire tax was void, and the court very definitely held, under the immunity rule laid down by Judge Marshall in the *McCulloch v. Maryland case*, that municipal bonds could not be taxed under any legislative act of the Congress of the United States. The case also held that the income tax was void because it was not apportioned according to population, it was

not a capitation tax in accord with the section of the Constitution I read to you a few moments ago.

The decision occasioned a great deal of vigorous, even bitter, discussion throughout the United States. Many of you who are older than I will doubtless recall it. I recall it in the latter days, because I was a student at college, from 1906 to 1910. The entire subject was thoroughly gone into by the people of the country. Everyone agrees that the agitation for the need and necessity for the sixteenth amendment grew out of the *Pollock case*.

The difference, as a matter of constitutional construction, lies here: Did the amendment arise out of the controversy over the matter of apportionment alone, or did it also arise out of the question of whether or not State and city bonds were subject to taxation by the Federal Government?

Senator CONNALLY. Senator, may I ask you a question right there?

Senator BROWN. Certainly.

Senator CONNALLY. Of course, I was not old enough to participate actively in public life, but in the amendment, when it was submitted to the States, was there any question ever raised that anyone knows anything about as to that being the issue, taxing State and municipal bonds? I never heard of it.

Senator BROWN. That was the main subject of the principal discussion of the chapters in both of these briefs, on the history back of the amendment.

Senator CONNALLY. I am speaking of the legislatures, when it was submitted to the legislatures for ratification. I never heard it discussed in my State, at least.

Senator BROWN. The highest judicial authority in the United States today then raised the question. I am about to read the present Chief Justice's letter upon that subject, but it is getting me a little ahead of my story. If you let me lay it aside for just a moment, I will revert to it, although I am quite close to it.

So I say that the question, it seems to me, on this phase of constitutional interpretation and construction is this: Did the income-tax amendment, the sixteenth amendment, come about because of the necessity for eliminating the apportionment feature alone or was there also discussion and a desire for a determination of the question of whether or not the income from State bonds could be taxed by the Federal Government. The argument pretty largely revolved around those two questions.

To my mind the most important factor in it is not what Governor Hughes said, which I will give you very soon, or what Senator Borah said, or what Senator Brown of Nebraska said, or Senator Root said upon that controversy, it is what the people of the United States understood at the time they, through their legislatures, ratified the sixteenth amendment.

What did they then understand? I have detailed to you the provisions of the Civil War Act and the provision of the 1894 act, which it must be remembered was the basis of the Pollock suit, and all of those acts contain the phrase that income should be taxed "from any source whatever." It is difficult for me to see how the people of the United States could differentiate between the meaning of the phrase "from whatever source derived" and the phrase "from any source whatever." The phrase "from any source whatever"

was accepted by everybody in the United States, from 1864 down to 1894, to include taxation of salaries of State officials and the taxation of the income from municipal and State bonds. There isn't any controversy over that subject, and that view is made clearer by the fact that the 1894 act took particular notice of *Collector v. Day* and expressly exempted State salaries from the provisions of the act, thereby, it seems to me, indicating that the phrase "from any source whatever" would have included State salaries if it were not for that specific exemption.

We have the several Civil War acts with this similar phrase "from any source whatever" which included income from salary and from State bond interest. The Court in the *Day case*, the Congress in its own construction of the language (Senator Hill, of New York, proposed an amendment during the consideration of the 1894 act, expressly exempting the interest on municipal bonds, which was rejected. Congressional Record, vol. 26, pt. 7, 53d Cong., 2d sess., p. 6510), the Treasury in its application of the law, and the people by general acceptance, all agreed that this plain phrase covered income from State salaries and State bonds. The 1894 act used the same phrase and the Court based its decision in the *Pollack case* on the fact that the phrase included income from New York City municipal bonds. The income tax agitation arose out of that decision. The new amendment used a phrase almost identical with the phrase used in the several statutes.

It seems impossible to me to reach any conclusion but this. If the plain meaning of the phrase "from whatever source derived" needs any illumination, then surely the meaning applied to the practically identical phrase by the Court, by Congress, by the Treasury, and by the people on the same subject matter must now be accepted as the meaning of the sixteenth amendment.

When the Congress submitted the sixteenth amendment there was little, if anything, in the Congress itself which would lend any light upon this subject. Nothing happened and no one discussed the meaning of the phrase "from whatever source derived" until Governor Hughes, in submitting the matter to the New York State Legislature, raised the point. I will not take the time to read the entire message. It is rather long. Governor Hughes, in his message submitting the question to the State legislature, said:

The comprehensive words, "from whatever source derived," if taken in their natural sense, would include not only incomes from ordinary real or personal property, but also incomes derived from State and municipal securities.

It is certainly significant that the words "from whatever source derived" have been introduced into the proposed amendment as if it were the intention to make it impossible for the claim to be urged that the income from any property, even though it consists of the bonds of the State or of a municipality organized by it, will be removed from the reach of the taxing power of the Federal Government.

The immunity from Federal taxation that the State and its instrumentalities of government now enjoy is derived not from any express provision of the Federal Constitution, but from what has been deemed to be necessary implication. Who can say that any such implication with respect to the proposed tax will survive the adoption of this explicit and comprehensive amendment?

There is nothing in the message which in any way intimates any other construction.

Senator CONNALLY. Was he recommending its adoption or opposing it?

Senator BROWN. He opposed its adoption. Governor Hughes was in favor of an income tax amendment, but he opposed the one presented because he considered that it permitted the taxation of interest from State and municipal bonds.

Senator CONNALLY. I judge from that language he was putting up that bugaboo to scare the legislature.

Senator BROWN. I raised that same argument, Senator Connally, in the committee and had some considerable difficulty over it.

That immediately occasioned widespread public expression. Senator Borah and Senator Root took strong exception to Governor Hughes' views, and Senator Brown of Nebraska, who was the author of the resolution, or Senator Borah, I have forgotten which—which one was it that introduced the resolution?

Mr. MORRIS (Assistant Attorney General). You mean the resolution to amend the Constitution?

Senator BROWN. The resolution to determine what the sixteenth amendment meant.

Mr. MORRIS. Senator Borah.

Senator BROWN. Senator Borah introduced that resolution. It was never adopted. He, in a very eloquent speech, took the opposite view from that taken by Governor Hughes.

Senator CONNALLY. Was that before the adoption?

Senator BROWN. That was before the ratification of the amendment.

Senator CONNALLY. That is what I meant.

Senator BROWN. Congressional action for submission had been completed. Senator Brown, the author of the resolution—I cannot read his language otherwise—shifted around considerably in his views. He said at one time that Senator Borah and Senator Root were right, and he said immediately after Governor Hughes made his statement that Governor Hughes was right, and I think it is fair to say that while the majority of his statements were favorable to the Borah view, yet he did take the other view at other times. He said this, in the first public comment of Senator Brown on the message of Governor Hughes:

So far as Governor Hughes' message is concerned, I am sure I cannot see why, if we are to make the taxing of incomes constitutional, we could not tax incomes regardless of source. It is just as much income if it is derived from national, State, or municipal securities as if it is derived from railway dividends, interest on corporation bonds, or any other industrial stock dividends, or the profits on any mercantile or manufacturing business.

So it cannot be said that Senator Brown was definite in his views, he taking both sides of the controversy.

If one were to take the State of New York alone, I think it would be rather easy to reach the conclusion that New York very definitely adopted the sixteenth amendment on the basis of the Hughes interpretation, because the then Republican legislature defeated the proposal to ratify. In the subsequent election Dix was elected Governor of New York, and it is quite certain that the issue was, in part, the sixteenth amendment. The Democrats, in their convention, adopted a plank in their platform favoring the adoption of the sixteenth amendment, and Governor Dix took the same view that Hughes did as to the meaning of the amendment and the subsequent legislature ratified the sixteenth amendment.

Now that cannot be said to be true of a great many other States, because a majority of the State legislatures had no opportunity to make a clear-cut decision upon that question. A few governors took the Hughes view and a few governors took the Borah-Root view, but except for New York, I do not know of any State where it could be said that the ratification was presented, in fact, to the people, and in New York, there were a good many other issues besides the sixteenth amendment.

All that I have said upon this question is said with this reservation, that the committee itself, and I myself, are by no means satisfied that either proposition is reasonably sure of a determination, favorable to the validity of these acts by the Supreme Court. My mind is still open on the subject, although I am inclined to the views that I have expressed. The committee itself goes no further than to say that they believe that the salary question can be differentiated from the bond question, and I will seek, in a few short moments that I will take, to point out what that difference is. If the sixteenth amendment is interpreted as I have outlined in the last few minutes here, it would justify both salary and bond taxation, but it is the view of the committee that salary taxation can be justified regardless of the provisions of the sixteenth amendment and regardless of the construction that has been placed upon the sixteenth amendment by *Evans against Gore* and other cases.

The States' attorneys general, in their presentation of the case, very strongly opposed the taxation of bonds, but they had very little to say about the matter of taxation of salaries. Solicitor General Epstein, of New York, whom I want to state publicly is one of the ablest attorneys I have ever heard, presented the views of the States. After the hearings were held he wrote me this letter, reading only the pertinent paragraph:

May I assure you that the conference's position on the salary question is precisely as I stated it to your committee. We take no position whatever on the propriety of the proposed reciprocal taxation of intergovernmental salaries. We do believe that there is a serious constitutional issue involved in such taxation without consent or constitutional amendment. But the conference as such does not wish to have the salary issue in any way involved in the matter of the proposal to tax the interest on State and municipal bonds. This last is the one vital question on which the conference takes a definite position of opposition to the proposal.

That is the bond proposal.

The CHAIRMAN. Let me ask you, to get clear in my own mind something that you said about the *Evans case*; that is the case where the judge's salary was involved?

Senator BROWN. Yes; a Federal judge.

The CHAIRMAN. Did not the Congress pass a law, after we had passed the last income-tax law, that the taxes from a Federal standpoint were to be applied to judges who were to be appointed in the future but were not to affect the judges appointed in the past?

Senator BROWN. That is right, Mr. Chairman.

Senator DAVIS. There is nothing in the pending legislation that makes any part of this retroactive?

Senator BROWN. That is right, sir. Am I wrong about that, Mr. Morris?

Mr. MORRIS. Senator, as I understand the Senator's question, if it had reference to the *Evans versus Gore* case, it was the kind of statute that had application only to future appointed judges. That is the law now.

Senator BROWN. I think we understand that all right. Now the justification, Mr. Chairman, for a distinction between the taxation of salaries and the taxation of bonds, as I see it, rests here: The rule of immunity announced in the *McCulloch v. Maryland case* is the basis for all of this discussion. It is felt by a great many that we should look at the fact and determine whether or not the levy of a tax upon a State bond is in reality a burden on the State sufficient to interfere with the exercise of its essential governmental function; second, whether or not the levy of a tax upon the Governor, to take the most outstanding example—of the State is a tax laying a burden sufficient to interfere with the exercise of an essential governmental function.

The facts show that the levy of a bond tax—and when I use that term here everyone will understand what I mean, and in this informal discussion it will do—the tax on the income from State bonds will amount to a direct burden upon the State of from 40 to 75 cents additional on a \$2 or \$3 interest coupon, which is substantial. In other words, municipal and State bonds will have to bear a much higher interest rate in order to sell in the market in competition with other capital. But the levy of, say, a 5-percent tax upon the salary of a Governor of a State is inconsequential, does not amount to much, and it is a fiction to say that such a tax amounts to an interference with an essential governmental function. One must admit that it is a question of degree, but that is the justification for a distinction between the two.

Senator RADCLIFFE. Senator Brown, do you think that degree could affect the question of constitutionality?

Senator BROWN. Yes; it has in the past. Senator Radcliffe. One cannot read the line of cases which, as I say, have chiseled away State and Government taxation without realizing that it is a question of degree.

Senator RADCLIFFE. What would be the standard in that case?

Senator BROWN. Whether or not the tax interferes substantially with the performance of governmental functions by the State. Certainly one can take the view—I do not know that I agree with it—one can take the view that an imposition of a much higher interest burden, say 25 percent additional interest, on the State burdens the State itself, interferes with the State's financing operations, but it is pretty difficult to say that an imposition of the 5-percent income tax, say, on the salary of the Governor of the State is an interference with the operations of the State itself. Now I am just pointing out what the distinction is.

Senator RADCLIFFE. Would not the determination of that question be almost an impossible one to work out?

Senator BROWN. Lawyers do not think so. I read you what counsel for the States say in that respect. I asked Mr. Epstein, the Solicitor General of the State of New York:

The CHAIRMAN. Do you think there is some difference between the right of Congress to impose a tax on the salaries—on the salary of the Governor of New York—and the right of Congress to impose a tax on the income from securities?

Mr. Epstein replied:

Let me give you my analysis on that, Senator, if you please.

The taxation of salaries may not impede the actual operation of the Government, and, as has been pointed out by Mr. Justice Stone, it does not follow that

the taxation of the salary of an official would mean the nonperformance of his services, and it does not mean that the State would lose revenues, or that you would have to increase his salary.

The taxation of interest on bonds takes an entirely different turn, and has an effect on the borrowing power of the State. So, you have there a basis for distinction.

Then I asked Mr. Cohen, who is another very distinguished and able lawyer, who was attorney for the New York Port Authority in the *Gerhardt case*:

The CHAIRMAN. You do feel that the constructions with respect to taxation on State securities by the Federal Government is on a somewhat different basis than the question of the right to tax the salaries of State officials?

MR. COHEN. When we say "somewhat," we are going into a wide field. By that, I mean that it is possible for the Supreme Court of the United States to hold that the salaries are taxable, and that the securities are not taxable.

Then Mr. Wood—I suppose Mr. Wood's reputation is known—
Senator CONNALLY (interposing). Senator Brown, may I interrupt you right there?

Senator BROWN. Yes.

Senator CONNALLY. In the case of salaries, the effect on the State would be indirect?

Senator BROWN. Yes.

Senator CONNALLY. In the case of bonds it would be direct?

Senator BROWN. It would be probably direct.

Senator CONNALLY. The State has its bonding power, its financing power.

Senator BROWN. I am not ready to concede that it is direct, but it comes much closer to being direct than in the case of a tax on salary.

Senator CONNALLY. I do not mean within the meaning of the Constitution, but I mean the salary is one degree removed from the State.

Senator BROWN. Yes; I grant that.

Mr. Wood is probably the foremost authority on municipal bonds in the United States. He is a member of the firm of Thompson, Wood & Hoffman. I know in my practice heretofore I heard a great deal of Mr. Wood's ability. I asked him the question about the distinction between the power of taxation of salaries and taxation of bonds, and Mr. Wood said:

While the courts, both before and since the ratification of the sixteenth amendment, have recognized the limitations which the system of dual sovereignty has imposed upon the taxing powers of the State and of the Federal Government, they have also been aware that these limitations must not be extended too far or they likewise would impair, if not destroy, the very system, the existence of which they were necessary to preserve. Both the State and the Federal Government must raise revenue, and if the principle of immunity were carried too far, the reciprocal immunities would seriously impair the ability of each sovereign to raise revenue. The courts have, therefore, refused to apply the doctrine to taxes, which are not levied directly upon the exercise of a sovereign power, but which affect it only remotely. This distinction is brought out by two cases like *Helvering against Gerhardt* and cases involving the taxation of bonds of governmental agencies, or the income derived therefrom.

What he referred to were cases like the *James v. Dravo Contracting Company* (302 U. S. 134).

Where unquestionably there is some additional burden on the Federal Government from the imposition of an income tax, such as an income tax upon a State contractor, as was the *Dravo case*—Dravo was building dams on a river in West Virginia—and it was there

held the State of West Virginia could impose a tax upon his income regardless of the fact that it would impede or at least add a burden to the Federal Government, although I think in that case the Government conceded that the burden would be slight.

The salary cases ended up with the *Gerhardt case*, which I will briefly review for you. Mr. Gerhardt and others were employees of the New York Port Authority. The New York Port Authority is a bi-State corporation, exercising rights, duties, and privileges of the States of New Jersey and New York in building and operating bridges, harbors, various port operations in and about the harbor of New York. Mr. Gerhardt was an employee, and it was held he was subject to the Federal income tax.

That was immediately followed by the case which is now pending, *Graves v. O'Keefe*, No. 478, in which the State of New York, following the reciprocal idea, said if Gerhardt is subject to Federal tax then O'Keefe, who is an employee of the Home Owners' Loan Corporation in the city of New York, is likewise subject to tax under the New York State income-tax law. The New York Court of Appeals struck down the tax, after it had been upheld in one of the lower courts and the case is now here, and the rather interesting and startling feature is that the Government has intervened and has conceded that O'Keefe is subject to New York State taxation upon his Federal salary, and the Government even goes further. I asked Mr. Wenchel, the General Counsel for the Bureau of Internal Revenue, if their concession went so far as this, that the salary of the President of the United States is now subject to income taxation in the State of New York, and he said yes, that was the view of the Department. It is expressed in the Government's brief in the *O'Keefe case* in these words:

Whether there is such an exemption may, in one view, be largely a question of congressional intent. There is undoubted power in Congress to waive any immunity which could otherwise be claimed by an officer and employee of the United States. Congress has the power to extend the immunity to those who deal with the necessity or instrumentality in cases where they otherwise would be taxable, but here Congress has not acted either to exempt the officers or employees of the United States from such taxation or to make them liable. In the minds of Congress the question reduced itself to the principles of the constitutional law. We submit that the implications of the Constitution do not carry to the point that the salary paid by the United States to its officers and employees is exempt from a nondiscriminatory State tax upon the net income received by its citizens.

That is the present position of the Department of Justice.

Now, Mr. Chairman, I think that is all I have to say. From the public standpoint the interest is great. I happen to have here a letter from the Department of Justice showing the general public attitude as judged by newspaper support. Since the President's message of last April, and principally in the last few weeks, since this question became prominent in Congress, the newspaper clippings show as follows: Those not in favor are 22, those who favor constitutional amendment only 47, and those who are favorable, 279. So it could be summarized to be 279 pro and 69 anti upon the subject.

Now, I have taken a long time, but I want to say that I am ready to answer any questions.

The CHAIRMAN. On the question of taxing the income from State and local securities, your committee is not ready to make a report? Senator BROWN. We are not ready to make a report.

The CHAIRMAN. You are still considering that question?

Senator BROWN. That is right.

Senator GEORGE. Senator Brown, may I ask you to just briefly state what this bill does?

Senator BROWN. This bill, Senator George, is not in our jurisdiction. We report merely upon the general principle, but I, of course, am familiar with it.

It provides, in substance, that all Federal employees are subject to a nondiscriminatory State income tax. It imposes the present income tax on all State officers and employees. It then provides, in title II, that all State officials who might be said to be subject to the income tax heretofore by reason of the decision of the Court in the *Gerhardt case*, are exempt, and prevents the Bureau of Internal Revenue from taking any steps to collect those back taxes which it would be the duty of the department to go ahead and collect [those taxes] except such as heretofore have been taxed as a matter of practice.

Senator GEORGE. That is made prospective from December 31, last?

Senator BROWN. Yes; that is correct. There is no retroactive tax on any of these State employees contemplated now if this bill passes.

Senator GEORGE. Nor by the State or Federal officers or employees, save from December 31, 1938?

Senator BROWN. I think, Mr. Wenchel, that is the idea is it not?

Mr. WENCHEL (Chief Counsel, Bureau of Internal Revenue). Yes, sir.

Senator BROWN. Of course, we expressly authorize State taxation on Federal incomes from January 1939 on, but I do not know just what the situation would be if the State of New York attempted to tax the salary of Senator Wagner, I do not know what the situation would be.

Mr. WENCHEL. That is not taken care of in the bill.

Senator BROWN. That is not taken care of in the bill.

Mr. MORRIS. That might turn, Senator, on the question as to whether the Supreme Court in the pending case held that explicit and express consent was necessary. That is the question.

The CHAIRMAN. I am sure, Mr. Brown, that the committee is very appreciative of your explanation. It has been most illuminating and able.

Now, Mr. O'Brien, will you explain the details of the bill briefly so we will know just what it is?

Senator GERRY. I would like to ask the Senator a question. You used the word "nondiscriminatory" taxes in the bill.

Senator BROWN. That is in the bill.

Senator GERRY. Does that go to the point of preventing any excessive taxation, for example, on the salary of the Governor of a State?

Senator BROWN. I would say, Senator Gerry, that it is an analogous to the subject of the taxation of national bank stock by a State. We authorized taxation by the State of Rhode Island of any stock held by citizens of Rhode Island in a national bank, and we provide in it that that taxation must be on the same terms and conditions as taxation of State bank stock by the State of Rhode Island, and I think the idea in this bill is to permit that kind of income tax legislation.

Senator GERRY. You raised the question of taxation on any salary. Is there any question there as to the amount of the tax? For example, if you had a terrifically large tax on the Governor's salary it might interfere with State functions, it might interfere with carrying out his duties.

Senator BROWN. Of course, that is an exaggerated case.

Senator GERRY. I mean is this bill to prevent that sort of thing?

Senator BROWN. I would say so. You mean a Federal tax?

Senator GERRY. Yes; if a Federal tax did that how would that fit into your argument as to the constitutionality?

Senator BROWN. I do not think we could tax the Governor on a \$25,000 salary on any different basis than the president of a private corporation drawing \$25,000. It would be discriminatory if such an attempt was made.

Senator GERRY. That is what I thought you were getting at.

The CHAIRMAN. Mr. O'Brien, will you just explain briefly this bill?

STATEMENT OF JOHN O'BRIEN, ASSISTANT LEGISLATIVE COUNSEL, HOUSE OF REPRESENTATIVES

Mr. O'BRIEN. The bill contains two titles. The first title relates to prospective taxation of State employees under the Federal income tax and consents to the prospective taxation of Federal employees under the different State income-tax systems. Section 1 of title I expressly includes within the definition of gross income, for the purposes of the revenue act, compensation received as personal services rendered to any State or instrumentality of the State, or any municipality. In other words, every State and municipal officer is subjected to the Federal income tax for taxable years beginning after December 31, 1938, that is this year and future years. That is section 1 of the bill.

Section 2 removes the exemption of the present law of teachers in the public schools in Alaska and Hawaii. That is an exemption which I think has been carried since 1928. The exemption was originally put in on the theory that State school teachers were exempt from Federal income taxes, and therefore Territorial Alaskan and Hawaiian school teachers ought similarly to be exempt from Federal taxes. The consequence of section 1 is with respect to years beginning after December 31, 1938, State school teachers are subject to taxes and therefore the exemption of Territorial school teachers is stricken out.

Section 3 gives the consent of the United States to the taxation of compensation received after December 31, 1938, by a Federal employee. That taxation will be taxation imposed by any duly constituted State or municipal taxing authority having jurisdiction to tax. The taxation which is authorized is taxation which does not discriminate against the Federal officer or employee on account of the source of his compensation. When I say "Federal officer or employee," I mean not only officers and employees in the ordinary sense who are employed by the United States, or any branch of the Government of the United States, such as the judiciary, legislative, and executive, but also the new agencies, including corporations which have been created and from which an officer receives compensation. Is there any question on title I?

Senator GEORGE. Cannot the State tax the Army and Navy?

Mr. O'BRIEN. The State can tax the Army and Navy, if it has jurisdiction to tax Army officers.

Senator GEORGE. That is what I thought.

Senator CONNALLY. Mr. O'Brien, what is the practice now respecting school teachers? Are State school teachers subject to Federal income taxes now?

Mr. O'BRIEN. I understand the Treasury has not tried to collect taxes from State school teachers.

Senator CONNALLY. It has not?

Mr. O'BRIEN. It has not.

Senator CONNALLY. Under this act they would be taxed?

Mr. O'BRIEN. Senator, this section 1 does say that State school teachers are subject to Federal income tax for taxable years beginning after December 31, 1938. That is this year and future years.

Senator CONNALLY. That is what I say. Under this act they would be taxed?

Mr. O'BRIEN. That is right.

The CHAIRMAN. Are there any other questions?

Mr. O'BRIEN. Let me go into title II. Title II relates to the retroactive imposition of Federal taxes on State officers. You might, perhaps later, want to go into executive session as to the precise details of the bill, but I can tell you generally what the scheme is.

The scheme is this: If you have the class of officer who has traditionally been subject to the Federal income tax, such as the State liquor store employee, or the State employee who is engaged in running what has traditionally not been thought to be essentially a governmental function, such as a street-car line or a power plant, he is not given relief on account of the imposition of income taxes upon him. In other words, he is the kind of man who has always been paying the tax. There is no attempt to give him this tax back, if he has paid the tax. The attempt has been made to distinguish between this case and the cases in which the State officer and employee has been surprised by the recent court decision.

If you have one of these employees, not the traditionally taxed employees, I mean a Government school teacher, even an employee of the New York Port Authority, who has not paid his tax, he does not have to pay his tax. If he has paid his tax for back years, he gets his tax back with interest. That rule applies not only with respect to taxation for back years 1937, 1936, but back to previous years. It also applies to his taxes for the taxable year 1938. That is, he will not have to file a return on March 15, 1939, with respect to his 1938 income.

Furthermore, in the case of a man who has been surprised by *Helvering v. Gerhardt*, who did pay his tax notwithstanding the fact he was prior to that case not thought to be subject to the tax, he gets his money back for 1937 and previous years. We think there are going to be very few of those cases, but in order to make absolutely sure, we have provided if he paid his tax and the application of the taxing provisions would result in the application of the doctrine of *Helvering v. Gerhardt*, then he gets his tax back with interest.

The CHAIRMAN. Let me ask one of the Treasury representatives; what do you estimate as the total amount of refund?

Mr. THOMAS TARLEAU (legislative counsel, Treasury Department). That is very difficult to say, Mr. Chairman, but we do not believe that it will run over \$1,000,000. The fact is, the amount of taxes that have been collected within the statute of limitations, from this particular type of employee, has been so little that we do not believe the claims could amount to more than \$1,000,000.

The CHAIRMAN. All right, Mr. O'Brien.

Mr. O'BRIEN. Mr. Tarleau just touched upon a point which I think is an important point to be considered in title II. In cases in which the tax is going to be refunded on account of the claim, or the institution of another kind of proceeding for the purpose of getting the tax back, the tax will not be given back to the man unless he filed his claim in time, or unless the statute of limitations, in other words, had not run against him.

There are further provisions. Section 205 of the bill excludes from the definition of compensation of officers or employees as officers and employees only compensation paid directly or indirectly by the United States.

I might, on that point, enlighten you briefly. There was before the Ways and Means Committee a good deal of discussion as to who should get this retroactive relief, and there are a number of cases in which it was shown that there were certain officers and employees of the State who did not get their money from the State or from any instrumentality of the State as salary or wages or compensation. They get their money by fees which they levied against certain classes of people who had dealings with the State.

For instance, there are a number of masters in chancery and other court officers in a number of States—Illinois and States like that—who got no salary from the State whatsoever, but in the exercise of their functions are able to deduct from the charges for litigation an amount which sometimes, I understand, was approved by the court, which they took out of the client, and yet they were regular State officers and carrying out State functions. They took an oath of office to support the State, and so forth.

Similarly, I understand, there are a number of instances in which bank liquidators occupy the same position. There are people who, out of the proceeds of the bank liquidation, collect their compensation, and they were State officers. Now, with respect to those people, since they are in exactly the same position as other officers in other States who perform the same functions and get their salaries from the State, those people are entitled to recover their tax which has been paid, are entitled not to be proceeded against if their tax is not paid, and do not need to file a return in March of this year for 1938.

The last section of title II provides that if title I, which taxes State officers and which grants the consent of the United States to the taxation of Federal officers by the States, is held unconstitutional then title II shall not be affected thereby, and vice versa. If title II is held unconstitutional, then title I shall not be affected thereby. I think that is as brief an explanation as I can go into.

The CHAIRMAN. I have had a request that certain gentlemen might wish to be heard, but that is up to the committee. Mr. Hanes, did you have anything to say?

Mr. JOHN W. HANES (Under Secretary of the Treasury). No, sir; I do not think there is anything we want to add.

The CHAIRMAN. Does Mr. Tobin wish to make a statement?

STATEMENT OF AUSTIN J. TOBIN, SECRETARY, CONFERENCE ON STATE DEFENSE

Mr. TOBIN. Briefly, Senator, on behalf of the States attorneys general, we would like to put before the committee the request that this bill be split into two bills. The States attorneys general take no position. They feel that they cannot take a position on the question of taxing future salaries, for many reasons, including the obvious reason of being seriously misrepresented in their attitude.

The CHAIRMAN. It might be unpopular in the States.

Mr. TOBIN. They feel, sir, the difficulties of making clear the constitutional basis of their objection. They have two objectives, and have had two objectives throughout this tax discussion. The first one is the necessity, and the immediate and crucial necessity for the enactment of title II.

I might say, Mr. Chairman, that the effect of that act is far more real and dangerous one than is generally recognized. There has been some talk that there could be a liability of State and municipal employees under the decision in the *Gerhardt case*, which undoubtedly widened the scope and the field of Federal taxation of State employees, to 3 years, but the liability is far more serious than that. It would extend back for 12 years, because none of these State or municipal employees ever filed, or practically none of them, ever filed a report which would have set the statute of limitations in motion. The liability is so real that the Secretary of the Treasury would be unable to extend any clemency or mercy to these people, and there are, I think we may accurately say, hundreds of thousands of them throughout the country, because it will become his duty on March 15 to assess these people and to take from them whatever little property they may have accumulated, and to take from them their homes, unless some such legislation as this is enacted.

Very properly, in his sympathy and humanity, the President stressed that matter in his recent message and asked the Congress, and pointed out to them the necessity for the immediate passage of title II, which is noncontroversial, if the committee please. The court never intended such a result. The Treasury does not want to go through with such a result, and I am confident that the Congress does not want to and it is taking obviously every measure to avoid it, but I do want to make the point that there is a real and serious danger in putting the lion and lamb together in these two bills, titles I and II.

If you get into any constitutional controversy on the floor, as to the constitutionality and soundness of title I, something may happen that title II will not pass. We think that that is a real danger, and we think that the proper way for these two measures to be reported out would be as two bills.

Now, if the committee has any doubt as to the highly controversial nature of title I, may I simply call attention to the fact that

before the Ways and Means Committee, Mr. Morris, the Assistant Attorney General, very frankly answered Congressman Reed, in response to Mr. Reed's question with regard to this salary bill, "Do you personally entertain any doubt as to the constitutionality of the proposal which is brought here?" Mr. Morris replied, "I do not think I would be candid if I said that the question was one without doubt."

Now, if the Senators please, this future salary measure took 4 hours of debate on the floor, and I think from the character of the debate, and from the expression of those who participated in it, it could very easily have taken a great deal longer than that period to have been properly debated. It is a serious and difficult constitutional question, one, as Mr. Morris said, that is open to all kinds of doubt.

The doubt can be further illustrated by the fact that the report of the joint committee itself opens with the statement that "it is the opinion of this office that in order to effectively reach the compensation of all State and local officers and employees an amendment to the constitution will prove necessary."

We feel very strongly, the attorneys general of the States, that that type of bill should not be linked to this title No. II which is pure and simple justice and mercy to these employees, and it should not be linked to the other side of this picture, the attempt to extort the pound of flesh.

I might say that the State's attorneys general position on the salary bill can best be summed up in this paragraph. I quote from the brief which they placed before the special committee:

We shall show in dealing with the question of the power to tax the salaries of all State and Federal officers and employees, that the cases which established that immunity have not yet been overruled. Pending cases in the United States Supreme Court will give full opportunity for the discussion of those phases of constitutional law which are now sub judice. If the United States Supreme Court should uphold in toto the contentions of the Government, with reference to the present power to tax salaries, there will be no necessity for legislation, and probably no necessity even for a constitutional amendment. If the court should finally hold that a tax on any public officer's or employee's salary is not a burden on either Government in the performance of its sovereign functions, the States will not require any permission from Congress to tax Federal salaries, nor will the Federal Government require any permission from the States to tax any State officer's or employee's salary.

May I point out to the committee also that there is absolutely no need for immediate action on the question of future salaries, the way there is for the action on relieving the immediate danger of the imposition of this 12 years' retroactive tax. The bill, in its present form, does not purport to tax salaries until 1940, whereas its action is needed immediately on the question of the retroactive tax.

There is no need for debate on the retroactive question. Everybody is agreed on it. Why should it be tied up and put into the same basket with this other question arising in title I which, obviously, will require debate and will probably be debated, and which raises a most serious constitutional question with which I am confident the Senate will adequately deal?

May we point out in conclusion the lack of necessity for joining these two titles together, that there is absolutely no need for passing title I whatsoever. The Treasury Department right now, if it has the constitutional power, has the full statutory power to tax the salaries of every State and municipal employee from the Governor

down. That appears clear from the revenue acts of 1918 to date. It was made clear, and it is made clear in the report of the joint committee where, on the opening page of their report, they point out that existing revenue laws tax compensation of State and local officers and employees to the fullest extent permitted under the Constitution. And again, at pages 36 to 39 of their report, where it is pointed out that ever since the Revenue Act of 1918, when the exemption to State and municipal employees was taken out of the statute, there has been full and complete power in the Treasury Department to tax all of these salaries. It is pointed out also that this conclusion was reached by Mr. Justice Stone in the *Gerhardt case*, who pointed out that the 1932 act which governed that case, did not authorize the exclusion from gross income of the salaries of employees of the State.

Now there is this point also, that there is absolutely no need for the enactment of this title which is in effect rather a solemn mummery, declaring simply what is the law to be the law, so far as the statute is concerned. That was also made clear by Representative McCormack in the hearings before the Ways and Means Committee of the House. He pointed out that under the 1918 act, and under the 1926 act, there was full power existing by statute, if you had it by the Constitution, to tax the salaries of State employees, and then Representative McCormack asked Mr. Morris, or, rather, said to him, "So far as the State and political subdivision employees are concerned, the power has existed since 1926." And Mr. Morris replied:

I shall not dispute the Congressman on that point, and I may even go one step further and say this: That in the *Saxe case* * * * the Government had intended * * * to assert before the Supreme Court the various contentions that should be considered in that light even though there be no such statute such as has been proposed. * * *

Mr. McCormack then said:

What you are saying is that if Congress would act affirmatively, it would reinforce your argument.

And Mr. Morris replied:

I do not think there is any doubt about that.

And again he said:

* * * The question could, it seems most likely, be considered afresh with more force if there was an express intention on the part of Congress to tax those salaries.

There is, if the committee please, now pending in the Supreme Court, the *O'Keefe case*, in which the Government, in its very able brief in that case, has argued that it has and should have full power to tax the salaries of State officers and employees without the enactment of any statute whatsoever, and clearly, since they make that argument there, no statutory barrier is standing in their way. We simply say, if the committee please, that with these serious questions, with the fact that there is no requirement of haste in the salary question, with the fact that you are bound to face a serious constitutional debate on the floor, that you should not join a measure which is simple justice and mercy to hundreds of thousands of employees and endanger its immediate passage before March 15 by hooking it up to this highly controversial question.

The **CHAIRMAN**. Thank you, Mr. Tobin. I am inserting in the record a statement regarding the pending bill submitted by Mr. Jacob Baker, president, United Federal Workers of America. (The statement is as follows:)

STATEMENT SUBMITTED BY JACOB BAKER, PRESIDENT, UNITED FEDERAL WORKERS OF AMERICA

My name is Jacob Baker. I am president of the United Federal Workers of America, affiliated with the Congress of Industrial Organizations, and having members in all of the executive departments both in Washington and the field. The United Federal Workers of America wishes to record its support of H. R. 3700, now before the Senate committee.

In general, this view is the following: The increase of Government function in the States and municipalities, as well as in the Federal Government, requires a broadening of the tax base. At the present time the alternative to a broadened base of income taxation is an increase in sales and excise taxes. It seems unquestionable to us that the income-tax method is much more fair and equitable. Although the passage of this act will undoubtedly encourage the levying of income taxes in many of the States upon Federal employees, we feel that, even so, these income taxes will bear less hardly upon low-paid Government workers than will sales taxes, business-privilege taxes, or any other taxes that are apt to be developed.

The **CHAIRMAN**. The hearings are now closed and the committee will go into executive session.

(Whereupon, at 11:45 a. m., the hearings were closed and the committee went into executive session.)

(Subsequently the following telegram was received from Mr. Julius Henry Cohen, general counsel, the Port of New York Authority, New York City, and was ordered printed in the record:)

NEW YORK, N. Y., February 22, 1930.

Senator **PAT HARRISON**,

Chairman, Finance Committee, Senate, Washington, D. C.:

Since my name was mentioned in the hearing before your committee yesterday as apparently concurring in certain views expressed by others, I wish to make it clear that while I joined in the general policy of not discussing taxation of salary as a matter of public policy, I did not intend to give the impression that I concurred in the view that the statutory method proposed was unobjectionable on constitutional or legal ground. I quote from the brief signed by the State attorney general and by me on page 7: "The attorney general refrains from discussing the general questions of public policy involved in the salary phase of the proposal, they would not seem, however, sub silentio to accept those contentions of the Government in the field of salary which deal with the constitutional questions now pending in the courts, and so far as the constitutional questions are germane to both fields they will be found to be fully covered in this memorandum." The germane constitutional questions will be found in chapters 1, 2, and 3 of part 1 in A, B, C, D, E, and F, and chapters 5 and 7 of part 2, and the whole of part 3 of the brief. Will you be good enough to make this telegram part of the record before your committee so as to avoid any misunderstanding as to my position.

JULIUS HENRY COHEN.

(Subsequently the following letter was received from Mr. Edward A. O'Neal, president, American Farm Bureau Federation, and was ordered printed in the record:)

AMERICAN FARM BUREAU FEDERATION,
Washington, D. C., February 22, 1930.

Hon. **PAT HARRISON**,

Chairman, Committee on Finance, United States Senate,
Washington, D. C.

My DEAR SENATOR HARRISON: On behalf of the American Farm Bureau Federation, I desire to convey to you as chairman of the Senate Finance Com-

mittee our endorsement and support of the Doughton bill, H. R. 3700, authorizing the reciprocal taxation of salaries of Federal, State, and local governmental employees. At the recent meeting of our national legislative committee here specific authorization to support such legislation was approved.

As early as 1921 the American Farm Bureau Federation enunciated as one of the foundation principles of its national tax policy the following: "As this is a country of all the people, all the people should have some part in supporting the Government."

Another cardinal principle of equitable taxation which the federation has constantly advocated over the years is that taxation should be based primarily upon ability to pay.

Measured by either of these standards, the continued exemption from taxation of salaries of governmental employees, whether Federal, State, or local, is unjustifiable.

The purpose of the Doughton bill is to permit the taxation of salaries of all officers and employees of government under the Federal and State income-tax laws in the same manner as the salaries of all other citizens of the United States. As a matter of plain equity, governmental employees should bear their equitable share in supporting the functions of government to the same extent as any other citizen.

We hope this measure will be enacted into law.

Sincerely,

EDW. A. O'NEAL, *President.*

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