It is the purpose of this article to present a summary and analysis of the provisions of the Revenue Act of 1940, the first of the two major revenue acts enacted during that year containing sundry amendments to the Internal Revenue Code. The Act became law by presidential approval on June 25, 1940. Reference will be made only incidentally to the Second Revenue Act of 1940, containing the very complex excess-profits tax law, special provisions relating to amortization of defense facilities, substantial increases in corporation income tax rates, an important section relative to earnings and profits of corporations, a provision relating to credit against federal unemployment taxes imposed by section 901 of the Social Security Act for the calendar years 1936, 1937, and 1938 and by the Federal Unemployment Tax Act for the calendar year 1939, a title relating to national service life insurance and provisions affecting the Railroad Retirement Board, and various other provisions. The Second Revenue Act of 1940 became law by presidential approval on October 8, 1940.¹

Unlike the Second Act, the Act which is the subject of this article is strikingly simple in its structure. It is nonetheless important for its provisions increased the federal tax burden by an estimated amount of approximately a billion dollars annually. The impact of the changes in various rates and in the personal income exemptions has already been felt and will be acutely manifest to taxpayers filing income and gift tax returns in March of 1941 and thereafter.

The simplicity of the Act, in striking contrast to the revenue acts which preceded it, particularly since the Revenue Act of 1934, and the Second Act which followed it, is principally attributable to the fact that the measure was framed and drafted in a very short time.

*Member of the San Francisco bar; Lecturer in Law, University of California; A.B., University of Southern California; J.D., Stanford University; formerly Assistant General Counsel, United States Treasury Department; author of articles in various legal periodicals.

¹For convenience and in order to avoid wearisome repetition, throughout the article the Revenue Act of 1940 will be referred to as the Act and the Second Revenue Act of 1940 as the Second Act. Also, except where it is otherwise specifically indicated in context or footnote, all references to numbered sections are to such sections in the Internal Revenue Code.
solely as a revenue-raising measure. Consequently, the amendments it contains were limited for the most part to simple changes in rate schedules, personal income exemptions, and the imposition of an additional ten per cent tax, labelled a defense tax, for a five-year period, applicable to all but a few of the taxes imposed by the internal revenue laws. There is a complete absence of the more or less complicated provisions aimed at closing so-called loopholes for tax avoidance and the fundamental changes or reforms of the taxing structure, promoting social and economic policies of the administration, such as the controversial undistributed profits tax, which characterized the Revenue Acts of 1934, 1935, 1936, and 1937. Equally absent are the ameliorative and relief provisions aimed at promoting business confidence and encouraging a freer flow of capital investment, such as the emasculation and final abandonment of the undistributed profits tax of 1936 and the sweeping revision of the treatment of capital gains and losses, which were the dominant features of the Revenue Acts of 1938 and 1939.

It is true that consideration was given by the Ways and Means Committee of the House to the possible inclusion of excess-profits taxes and special amortization provisions for national defense industries in the bill, but the Committee decided that these measures were necessarily related and involved a complicated and exhaustive legislative project requiring further extended study by technical assistants and Treasury experts. Decision was made to postpone action thereon, with instructions to the experts to accelerate their work in order that a bill retroactive to 1940 incomes might be ready for submission to Congress not later than the opening of the next session. Attempts were also made later in the Senate to incorporate excess-profits and war-profits taxes in the bill but these amendments failed of enactment by reason of elimination in conference, principally for the reasons advanced in the Report of the Ways and Means Committee. It is matter of history, of course, that action was not postponed until the new Congress but that such legislation found its way to the statute books a few months later in the Second Act.

The Act was an immediate result of the need for national preparedness which became suddenly and acutely felt throughout the nation in the early stages of the German "blitzkrieg" in Europe. On May 16, 1940, the President had sent a message to Congress pointing out the inadequacy of our means of defense against modern weapons of aggression and requesting defense funds in the budget for the
fiscal year 1941 totalling $3,250,000,000. This was merely a begin-
ning and was quickly followed by supplementary requests for stag-
gering sums totalling many billions of dollars, as the scope of the
defense program was successively expanded, culminating within a
few weeks with the measures for national conscription and the vast
additional expenditures which they will inevitably entail. Congress
quickly realized the utter inadequacy of the existing tax system to
support the great additional expenditures the national defense pro-
gram would involve, on top of a budget already out of balance by
several billions of dollars, although the full magnitude of the govern-
ment's fiscal need was but dimly foreseen or appreciated when the
legislative machinery commenced to move in the latter part of May.

The congressional action, once begun, was extraordinarily rapid.
The bill was reported to the House on June 10th and passed the
following day without amendment. Consideration by the Senate
Finance Committee was brief and the bill was reported to the Senate,
with a number of important amendments, on June 15th. The bill was
promptly passed, with some further floor amendments, by the Senate.
The considerable differences between the House and Senate bills
were promptly ironed out in conference, the conference report was
adopted in both houses, and the engrossed bill sent to the President,
who signed it on June 25th. Of course the measure, as finally enacted,
is wholly inadequate to meet the government's tremendous fiscal
problem and must for that reason be regarded as merely a stop-gap
and a foretaste of much heavier tax burdens to come. The same
observation applies, for that matter, to the Second Act. Nevertheless,
a tax bill which increases the national tax burden to the extent of
at least a billion dollars per year is entitled to be considered as one
of major importance. Moreover, in view of the speed which marked
the preparation and passage of the bill and the fact that it did not
purport to be a general revision of the revenue system, it must in
fairness be admitted that the Act represents a fair beginning in the
financing of the defense program and that the Congress did a good
job. As will appear hereafter, its sweep was broad, since few taxes
in the federal system did not feel its effects. Also, a study of this
act may afford some clues as to where the heavy increases in the
federal tax burden which are inevitable in the near future are most
likely to fall.

2 H.R. 10039, 76th Cong. 3d Sess. (1940).
In the interests of clarity and orderly presentation, consideration will be given separately to those parts of the Act which work changes in the revenue laws which are professedly permanent and those which make changes which are temporary in form.

The Act does not purport to be a taxing act which is complete in itself, but merely consists in a number of amendments to various sections of the Internal Revenue Code. It is made up of four titles. Title I contains permanent changes in the personal income surtax rate schedule, broadens the base by reducing the personal exemptions, increases the rates on non-resident alien individuals and non-resident foreign corporations, and increases the corporate income tax rates. Title II provides for so-called temporary defense taxes and a further extension of the life of a group of excise taxes commonly known as "nuisance" taxes. Title III provides for the earmarking of the proceeds of the defense tax for retirement of any obligations issued under the authority of the Second Liberty Loan Act as amended, and further amends the said Act by authorizing the issuance of not to exceed $4,000,000,000 in national defense obligations. Title IV amends the Public Salary Tax Act of 1939.

PERMANENT CHANGES

The most important and significant permanent changes in the federal revenue system made by title I of the Act are those which effectuate a marked broadening of the base of the personal income tax and a material stiffening of the surtax rates on the so-called middle income brackets.3

The broadening of the base was accomplished by reducing the personal exemption in the case of single persons from $1,000 to $800, and the exemption of married persons living together and heads of families from $2,500 to $2,000. These simple changes will operate to add to the roll of persons subject to personal income tax approximately 2,190,000 additional taxpayers. They are in line with proposals to broaden the tax base which have been offered, hitherto in vain, by Senator LaFollette in connection with virtually every major revenue bill since 1934. The reduction in the exemptions will alone produce an additional annual revenue somewhat in excess of one hundred million dollars, but it is important to note that only about

3 It is outside the scope of this article to consider the wisdom of the policy of broadening the base and taxing small incomes. For a recent discussion of this question see Strayer, The Proposal to Tax Small Incomes (1940) 7 LAW & CONTEMP. PROB. 171.
fourteen million dollars of this amount is expected to come from the new taxpayers added to the rolls. Since the normal tax rate of four per cent is left unchanged by the Act, and the surtax rates do not apply to surtax net incomes not exceeding $4,000, these new taxpayers will only be taxed four per cent on small segments of taxable income. It is evident from the above figures that the average amount of tax to be collected from the 2,190,000 new taxpayers will be less than seven dollars per capita. The revenue potentialities represented by this group of new taxpayers are much greater, however, than the above figures would indicate, since they will all be subject to increases in the normal tax rate which seem to be inevitable in revenue legislation to be enacted in 1941 and succeeding years. A doubling of the normal tax rate, that is, to eight per cent, would mean that the amount of tax paid by this group would also be approximately doubled.

Vastly the greater part of the additional revenue to be derived from this paring of the personal exemptions, probably between eighty-five and ninety per cent, will come from taxpayers already on the assessment rolls.\(^4\) This phenomenon is due to the operation of the highly graduated surtax rate schedule. Thus, in the case of a married man living with his wife or a head of a family, not only must he pay a four per cent normal tax upon an additional $500 of taxable income, but also a surtax, if his surtax net income, with or without the $500 addition, is large enough to place him in a taxable bracket. Moreover, for surtax purposes, the addition increases the taxable income in the top bracket, not the bottom one. In some cases, indeed, it may operate to shove the taxpayer across the line into a higher bracket. Thus, a married individual whose income was already subject to a surtax in the top bracket at the rate of fifty per cent will normally find his tax for 1940 increased by four per cent of $500, or twenty dollars (normal tax),\(^5\) plus fifty per cent of $500 or $250 (surtax), or a total of $270, by virtue of this change alone.

\(^4\) Report No. 2491 of the Ways and Means Committee, 76th Cong. 3d Sess. (June 10, 1940) 11, 12, and 13, contains three excellent tables, showing: (1) a comparison of surtax rates under the existing law and under the proposed bill; (2) a comparison of normal and surtax, under the existing law and under the proposed bill, for a married person with no dependents and all income earned; (3) a comparison of the total tax burden, under the existing law and the proposed bill, of a married person, with no dependents, and all income earned. For reasons of space, only the first of these tables is reprinted herein, infra note 9.

\(^5\) In some cases the net normal-tax increase might be slightly less than twenty dollars because of the operation of the earned income credit.
No changes were made by the Act in the credit of $400 for each dependent or in the earned income credit.

The above modification in the personal exemptions made necessary some correlative amendment of the statutory requirements for filing individual income tax returns. Under prior law, an individual, if single, was not required to file a return unless his gross income was $5,000 or more, or his net income was $1,000 or more. A married individual living with a spouse, unless a joint return were filed, was required to file a return only if his gross income were $5,000 or more, or his net income $2,500 or more, except that, if such individual and his spouse each had a gross income and the aggregate gross income were $5,000 or more, a return had to be filed. The new Act amended the return provision so as to require a return from a single individual if his gross income is $800 or more, and from a married individual if (1) such individual has a gross income of $2,000 or more and the other spouse has no gross income, or (2) if such individual and his spouse each has for the taxable year a gross income and the aggregate gross income is $2,000 or more. An individual who is married but not living with husband or wife is taxed as a single person and hence must file a return under the Act if his gross income is $800 or more.

Section 142, relating to fiduciary returns, was also amended so as to require a return from every estate having a gross income of $800 or more, from every trust the net income of which for the taxable year is $100 or more or the gross income of which is $800 or more, regardless of the amount of the net income, and from every estate or trust of which any beneficiary is a non-resident alien.

The foregoing amendments to the personal exemption and return provisions apply to taxable years beginning after December 31, 1939.

It is apparent that these changes in the return requirements go considerably further than the reduction of the personal exemptions actually required. They will operate to produce an enormous increase in the number of returns, including returns showing no tax due, which will be filed. This fact is recognized in the Report of the Ways and Means Committee where it is stated that the change will require approximately 8,000,000 additional returns; about 7,500,000 returns were filed annually under the prior law. In other words, the number of returns filed will be more than doubled. The justification advanced

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6 This was the case also under the prior revenue acts.
for these more drastic requirements is the failure of many persons to file returns upon the assumption that their income was insufficient, although they were in fact liable to file returns and to pay tax. The Report anticipates that substantial additional taxes will be collected as a result of these more rigid requirements. It is also apparent, in view of the vast number of returns now required to be filed, that the way has been opened for some future Congress to raise an additional revenue of several million dollars by imposing a moderate filing fee applicable either to all or only to non-taxable returns, payable when the return is filed.  

Title I of the Act not only substantially broadens the base of the personal income tax but materially increases the surtax rates on the brackets between $6,000 and $100,000. These increases are also, in the main, in line with amendments unsuccessfully offered by Senator LaFollette in recent years to revenue bills. Much point has been made on the floor of Congress and in the columns of the press and of periodicals of the fact that in the successive upward revisions of the personal income surtax rates in the Revenue Acts of 1932, 1934, and 1935, virtually the entire burden of increased personal income taxation had been thrown upon taxpayers in the higher brackets and the large number of taxpayers in the so-called lower and middle brackets, that is, up to $50,000, had been permitted to escape virtually scot-free. It is incontestable that these allegations were true in fact. Consideration of the question whether such leniency of treatment was due purely to short-sighted politics or was defensible upon rational grounds of policy lies beyond the purview of the present article. Suffice to say that the 1940 revisions largely remove the basis of these criticisms for the future.

No change was made in the surtax rates on the brackets up to $6,000. A zero rate still applies to the first $4,000 of surtax net income. The rate on surtax net incomes in excess of $4,000 but not in excess of $6,000 remains at four per cent. The increases begin at $6,000, although in the $6,000 to $8,000 bracket the increase in

8 Some form of filing fee requirement has been suggested a number of times. It would defray at least part of the administrative expense of handling non-taxable returns, and might be justified on that ground. Otherwise, it would hardly be consistent with the principle of ability to pay which is the basis upon which graduated personal income taxes are generally supported. Such a fee, if required, should in any event be small.

9 The following is a reprint of Table I of Report of the Ways and Means Committee, supra note 4, at 11. This table shows the changes in the surtax rate schedule made by the Act.
rate is only one per cent. Examination of the table in the footnote will disclose that, while the increase in rates is not uniform, there is some uniformity of increase in the rate of progression. Under the old schedule the rates jumped by one in the brackets up to $14,000, while under the new schedule the rates increase by twos. In the brackets between $14,000 and $38,000 the progression under the old schedule was by twos, whereas in the new schedule it is by threes. In the brackets between $38,000 and $50,000 the increase of one in the rate of progression is maintained. Under the old schedule the rate in the bracket from $50,000 to $56,000 was thirty-one per cent; under the new schedule the corresponding bracket, $50,000 to $60,000, bears a rate of forty-four per cent, or an increase in rate of thirteen per cent on incomes between $50,000 and $56,000. Similarly, in the bracket, $44,000 to $50,000, there is an increase of thirteen per cent in the rate of tax, that is, from twenty-seven per cent under the old schedule to forty per cent under the new. Under the new schedule, in the brackets from $50,000 to $100,000, the above rate of progression is reversed, and in the brackets above $100,000 the new schedule has rates identical with the old. It becomes obvious that the maximum increase in surtax rates falls on surtax net incomes between $44,000 and $56,000. With respect to surtax net incomes of $100,000 or more, the new surtax rate schedule produces a uniform increase of $6,780 in tax, as compared with the old.

The foregoing figures do not take into account the further increase in tax burden attributable to the additional ten per cent

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Table I.—Comparison of surtax rates, existing law, and proposed bill
“defense tax” imposed for a five-year period, which will be discussed later in this article. The total estimated annual additional revenue to be derived from the reductions in the personal exemptions and the new surtax rates is 252 millions of dollars. No breakdown of this estimate appears in the Committee Reports but it seems probable that the new surtax rates account for at least half of it.

Important changes were also made by the Act in the rates of tax applicable to income from United States sources of non-resident aliens not engaged in trade or business or not having an office or place of business in the United States, the revenue effects of which are apparently included in the above estimate. Such individuals are taxed under the prior law, unchanged by the new Act, only upon fixed or determinable annual or periodic income, such as wages, salaries and other compensation, dividends, interests, rents, royalties, and so forth, and are not taxed upon capital gains. Under prior law, such income was taxed at a flat basic rate of ten per cent, and such tax is normally withheld at the source. This tax is in effect a gross income tax upon income from the specified sources. By a special provision this rate could be reduced by treaty, in the case of residents of contiguous countries, to not less than five per cent. One such treaty, to wit, with Canada, had been negotiated and ratified. Subject to treaty provisions, the Act, by amendment to section 211(a), raised this rate to fifteen per cent, with respect to taxable years beginning after December 31, 1939. Correlative amendments were made to section 143, relating to the amount of tax required to be withheld at the source, but these latter amendments, for obvious reasons of fairness to withholding agents, were made effective only as of June 26, 1940, the day following the enactment of the Act. The Commissioner has exercised his power by regulation to require non-resident alien recipients of income on which tax had been withheld at the ten per cent rate between January 1 and June 26, 1940, to file returns thereof and pay the additional tax of five per cent, or rather six and one-half per cent when the defense tax is included.10 As indicated above, residents of Canada continue to be taxed at the five per cent rate fixed by treaty.

Under prior law, such non-resident alien individuals, other than residents of Canada, who had gross incomes from the specified sources of more than $21,600, which was the level at which the average effective rate equalled ten per cent, were subject to full normal and

surtax rates on such fixed or determinable annual or periodical incomes and were required to file returns, credit being allowed for taxes paid at the source, except that the aggregate of normal tax and surtax under sections 11 and 12 could not be less than ten per cent of the income from the specified sources. The new Act amended this provision so as to change "10" to "15" per cent, and "$21,600" to "$24,000", the latter being the point at which, under the increased rates, the tax equals an average effective rate of fifteen per cent.

Title I of the Act also amended relevant provisions of the Internal Revenue Code so as to increase somewhat the permanent rates of tax applicable to corporations and other taxpayers subject to corporation taxes. Inasmuch, however, as these amendments will in large part never become effective, having been supplanted by provisions of the Second Act prescribing much heavier increases in rate, it seems desirable at this point to analyze the combined effect of the two Acts upon the tax rates applicable to corporate incomes. The new excess-profits tax is, of course, excluded from this analysis.

The Act increased the rates of tax upon domestic and resident foreign corporations by one per cent. With respect to domestic corporations having normal-tax net incomes not in excess of $25,000, the special treatment prescribed by section 14 was not disturbed, the three brackets of $5,000, the next $15,000 and the next $5,000, remaining the same, except that the rates of tax applicable to the several brackets, namely, twelve and one-half, fourteen, and sixteen per cent, were increased to thirteen and one-half, fifteen, and seventeen per cent, respectively. In the case of domestic corporations with normal-tax net incomes in excess of $25,000, the rate of tax imposed by section 13(b)(1) was increased from eighteen to nineteen per cent. A corresponding adjustment was made in the alternative tax imposed by section 13(b)(2) on corporations having normal-tax net incomes slightly in excess of $25,000, the tax under the new Act being $3,775, plus thirty-three per cent of the excess over $25,000, instead of $3,525, plus thirty-two per cent of the excess provided by the existing law. This is a so-called "notch provision". Under the Act this alternative tax applies to domestic corporations with normal-tax net incomes in excess of $25,000 and less than $31,964.31, the latter figure representing the point at which the alternative tax provision ceases to produce a lesser tax and therefore becomes inapplicable.

The rate of tax was also increased from eighteen to nineteen per
cent in the case of resident foreign corporations, insurance companies taxable in the manner provided by Supplement G, and mutual investment companies taxable in the manner prescribed by Supplement Q. No change was made in the rates of surtax applicable to personal holding companies under section 500, or corporations improperly accumulating surplus under section 102. The "defense tax", herein-after discussed, was made applicable to these surtaxes, however, as well as to the other corporate taxes mentioned above.

An important increase was also made by the Act in the rates of tax imposed by section 231(a) of the Internal Revenue Code upon the fixed or determinable annual or periodical income from United States sources of non-resident foreign corporations. This increase was effected by eliminating the special rate of ten per cent applicable under prior law to dividends received by such corporations and applying to such dividends the same rate of fifteen per cent as was applicable to their other forms of taxable income. This change was also made subject to treaty provisions. In consequence of this saving clause, Canadian corporations remain subject to tax on dividends at a rate of five per cent, and Swedish corporations, under a tax treaty ratified with that country, at a rate of ten per cent. Correlative amendments were made to section 144, relating to withholding (of corporation income tax at the source, but these latter amendments were applied only to withholding on or after June 26, 1940, and before January 1, 1945, whereas all the foregoing amendments to the rate provisions were made applicable to taxable years beginning after December 31, 1939, and before January 1, 1945.\(^{11}\)

The above amendments were supplanted only in part by the further changes in the corporation income tax made by title I, section 101 of the Second Act. The amendments to sections 211(a) and 143, affecting non-resident alien individuals, and sections 231(a) and 144, affecting non-resident foreign corporations, were not disturbed and remain in effect. The rates of tax imposed upon corporations with normal-tax net incomes not in excess of $25,000 by the amendment to section 14(b) were not changed.

The important change in the corporation income tax made by

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\(^{11}\)Here also the Commissioner has exercised by regulation the authority vested in him so as to require non-resident foreign corporations, with respect to dividends received between January 1 and June 25, 1940, inclusive, on which a tax of ten per cent was withheld at the source, to file returns and pay an additional tax of five per cent of the amount of such dividends, or rather six and a half per cent when the defense tax is included. See Reg. 103, § 19.235-2.
the Second Act is that, with respect to certain categories of corporations, the rate was increased to 22.1 per cent instead of nineteen per cent prescribed by the Act. This heavy increase in rate applies to the following corporations:

(1) Corporations with normal-tax net incomes in excess of $25,000, subject to the tax imposed by section 13(b)(1). This includes (a) China Trade Act corporations subject to the provisions of section 261, (b) corporations the bulk of whose income is from sources within United States possessions, governed by section 251, and (c) insurance companies taxable in the manner provided by Supplement G, where their normal-tax net incomes, as specially determined under the provisions applicable thereto, exceeds $25,000.12

(2) Foreign corporations engaged in trade or business within the United States or having an office or place of business therein, and subject to tax under section 14(c)(1), regardless of the amount of their normal-tax net income.

(3) Every mutual investment company, taxable under section 362(b) upon its undistributed Supplement Q net income, regardless of the amount thereof.13

Because of this increase in rate on corporations having normal-tax net incomes in excess of $25,000, it was also necessary further to amend section 13(b)(2), the notch provision, providing an alternative tax for corporations with normal-tax net incomes somewhat in excess of $25,000. This was accomplished by providing that the alternative tax should be $3,775 plus thirty-five per cent of the amount of the normal-tax net income in excess of $25,000.

No changes were made in the surtaxes imposed on personal holding companies or corporations improperly accumulating surplus.

It is important to note at this point, however, that section 101(d) of the Second Act specifically limits the ten per cent defense tax, imposed by section 15 of the Internal Revenue Code, added to such Code by section 201 of the Act, in the case of corporations, to ten

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12 Under the Act such corporations would have been subject to tax at the nineteen per cent rate.

Corporations in these classes are entitled to the benefit of the lower rates where their normal-tax net incomes, as specially determined, do not exceed $25,000 and to the benefit of the alternative tax where their normal-tax net incomes, as so determined, slightly exceed $25,000.

13 Corporations which satisfy the criteria prescribed by Supplement Q are taxed only upon their undistributed Supplement Q net incomes, but in computing their net incomes are denied the benefit of the credit of eighty-five per cent of the dividends received from domestic corporations.
per cent of the tax computed without regard to the amendments made by section 101(a), (b), and (c) of the Second Act. Stated more simply, this limitation means that the defense tax is to be computed, in the case of a corporation, upon the basis of what its tax would have been had the Second Act not been enacted. Hence, the defense tax, in the case of an ordinary corporation, cannot in any case exceed 1.9 per cent of its normal-tax net income. A further complication is that one notch or alternative-tax provision will be applicable in computing the defense tax of certain corporations having normal-tax net incomes somewhat in excess of $25,000 and another and different notch provision in determining the normal tax they must actually pay. This seeming paradox results from the desire of Congress to prevent the defense tax from operating with disproportionate severity, in relation to other groups of taxpayers, upon those corporations caught by the higher corporate rates provided by the Second Act.14

The estimated additional annual revenue yield to be derived from the permanent readjustments of rates on corporation incomes made by the Act was seventy million dollars. The Report of the Senate Finance Committee on the Second Act estimates a gross additional revenue for the calendar year 1940, from the increase in the normal tax on corporate incomes, of 240 million dollars. It does not specifically appear to what extent there is an overlap in these two estimates, but it seems probable there is such an overlap to the extent of at least fifty million dollars.

TEMPORARY CHANGES

The changes of a permanent character made by the Act account for less than one-third of the billion dollars or more of additional revenue it is expected to bring into the Treasury's coffers. The balance, including a minor fraction to be derived from a sharp reduction of the exemption from the excise tax on admissions, is expected to be raised by the so-called "defense tax" to which reference has been made several times. The defense tax is not a single tax. Strictly speaking, there are almost as many separate defense taxes as there are different taxes under the Internal Revenue Code. Each such tax was imposed by an amendment of the section imposing the tax which it supplements, except that the addition of a single new section,

14 The operation of these "notch" provisions is more fully and concretely explained at a later point in this article.
numbered 15, was found adequate to apply the additional tax to all taxes upon incomes imposed under chapter I of the Internal Revenue Code. But all these additional taxes have certain basic features in common.

The first common feature is that they are all temporary and by their terms their duration is limited to five-year periods, though for obvious reasons their expiration dates are not all the same. The second is that the proceeds of all these defense taxes are required by the Act to be segregated by the Secretary of the Treasury into a special fund earmarked for retirement of obligations issued under the Second Liberty Loan Act, as amended, including four billion dollars of national defense obligations authorized by an amendment to that Act made by section 302 of the Revenue Act of 1940. Excluded from this earmarking provision is so much of the revenue to be derived from the Admissions Tax as is attributable to the tax on a basic admission charge of forty-one cents or more imposed by section 1700(a)(1) prior to its amendment by section 211 of the Act.

Also excluded from such earmarking are amounts collected which are solely attributable to section 209 of the Act. Section 209 extends until 1945 the life of a group of excise taxes which would otherwise, if not renewed, have expired by limitation on June 30 or July 31, 1941. In a few cases the taxes would not expire, but a temporary increase in the rate first made in the 1932 Act would no longer be operative. In these cases section 209 continues the higher rates until 1945.

The taxes so extended by section 209 of the Act are the residuum of the so-called nuisance taxes first imposed in the struggle to balance the budget in 1932. Only a few of these 1932 taxes have been eliminated, or their rates reduced, during the intervening years. Though in form temporary taxes, they have been extended so many times by a reluctant Congress, hard-pressed for revenue and unable to find substitute sources, that it is almost ironic to classify them still as temporary levies. He would be a rash prophet who would predict that they will not be renewed again before their 1945 expiration dates.

Although these supplemental taxes are in the main ten per cent of the amount of the respective taxes computed without regard to the additional taxes, this is by no means true in all cases. In a number of instances involving excises, a so-called “defense tax rate” is substi-

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15 In a few instances, such as the gift tax, the defense tax increase will be in effect for a period slightly in excess of five years.
tuted for the old rate, and in several of these the new tax is much greater than 110 per cent of the old. In a few other instances, such as the cigarette tax, the increase in rate provided for the five-year period is less than ten per cent.

A review of the various defense taxes is now in order. Most important as revenue producers are the defense taxes added to the various taxes on personal and corporate incomes, the alcoholic-beverage taxes, and the manufacturers' excise taxes, particularly the tax on gasoline.

Income Taxes.—The defense tax, imposed by section 15 of the Code, added by section 201 of the Act, applies to taxable years beginning after December 31, 1939, and prior to January 1, 1945. The additional tax is, in effect, ten per cent of the amount of the tax computed without regard to section 15 and before the application of the credit provided in section 31 (foreign tax credit), and the credit provided in section 32 (taxes withheld at source). In order to cushion somewhat the otherwise harsh impact of the tax upon individuals falling in the higher brackets of the surtax, section 15 specifically provides that in no case shall the effect of the section be to increase the tax computed without regard to such section by more than ten per cent of the amount by which the net income exceeds such tax. Without such a cushion, a flat ten per cent increase on top of surtaxes reaching seventy-five per cent might work virtual confiscation of income in some cases. Suppose, for instance, an individual has a surtax net income of $2,000,000. His effective rate of tax under the Act, without the defense tax, would be 72.81 per cent. Without this cushion, the ten per cent defense tax would increase this effective rate by 7.28 per cent, or to 80.09 per cent. Since these figures do not take into account heavy state income taxes such a taxpayer might be liable to pay, it is obvious some relief for such individuals was both proper and necessary. Under the above provision, the defense tax in the case given would be limited to 2.72 per cent of the surtax net income, giving a total effective rate of 75.53 per cent. This cushion begins to operate when the effective rate of tax exceeds fifty per cent of the taxpayer's net income. This point is reached with net incomes of approximately $180,000.

One of the few possible complications arising in the application of the defense tax is the direct result of the form in which this above limitation is stated in the statute. There will be some cases in which an individual will have no statutory net income because his ordinary
net income is exceeded by a long-term capital net loss. Yet he may be compelled to pay a tax because of the alternative tax computation prescribed by section 117(c)(2). For instance, suppose an individual has an ordinary net income for the taxable year 1940 of $250,000, leaving his capital losses out of account. He realizes long-term capital losses in 1940 of $600,000 and no offsetting long-term capital net gains. Since fifty per cent thereof, or $300,000, are taken into account and are deductible under section 117(b), it is clear that he has no statutory net income for 1940. Yet, because of the operation of section 117(c)(2), he will be required to pay a tax in excess of $40,000. Since this tax exceeds his net income, which is here a minus quantity, it would seem, under the language of the limitation in section 15, that he would not be required to pay an added ten per cent of the above amount of tax as defense tax.\(^{16}\)

In the case of the non-resident alien individuals taxable under section 231(a), the effect of the defense tax is to increase the rate of tax during the five-year period from fifteen to sixteen and one-half per cent, except that section 202 of the Act provides that the increase shall not apply where it would be contrary to treaty obligation. The increase therefore does not apply to residents of Canada. Section 202 also amends section 143 of the Internal Revenue Code to require withholding after June 25, 1940, at the sixteen and one-half per cent rate where not contrary to treaty.

In the case of the corporation income tax, the defense tax is ten per cent of the tax computed without including the defense tax, but the tax so computed is the tax at the rates provided by the Revenue Act of 1940.\(^{17}\) It follows that the rates of tax, including defense tax, for corporations with normal-tax net incomes not in excess of $25,000 are 14.85 per cent (13.5 plus 1.35) for the first $5,000, 16.5 per cent (15.0 plus 1.5) for the next $15,000, and 18.7 per cent (17.0 plus 1.7) for the next $5,000. With corporations whose normal-tax net incomes exceed $25,000 and which do not fall under the alternative tax, the rate is 22.1 per cent (imposed by the Second Act) plus 1.9 per cent defense tax (ten per cent of the nineteen per cent rate provided by the Act) or a total aggregate rate of twenty-four per cent.

\(^{16}\) It is specifically stated in the Report of the Ways and Means Committee, supra note 4, at 15, that this result is actually contemplated and intended. In any event, it would be difficult to avoid in view of the manner in which the defense tax limitation in section 15 is phrased.

With respect to corporations whose normal-tax net incomes somewhat exceed $25,000, the computation of the total tax, including the defense tax, may give rise to some difficulty and confusion, unless the various steps in the computation are clearly understood. The difficulty arises from the fact that the notch or alternative-tax provisions of the two acts are not the same, and the further fact that the rates, including the alternative tax rate, of the Act apply for purposes of the defense tax, while only the rates of the Second Act, including its alternative-tax rate, apply in computing the normal income tax of corporations whose normal-tax net incomes exceed $25,000. Fortunately, any difficulties of computation can be avoided by using simple arithmetical formulae. The first fact to bear in mind is that the notch provision of the Act applies to corporations whose normal-tax net incomes exceed $25,000 and do not exceed $31,964.30, while the notch provision of the Second Act applies to corporations whose normal-tax net incomes exceed $25,000 but do not exceed $38,565.89. These figures are the result of simple mathematical computation.

It is immediately apparent that all corporations which are within the notch under the Act are also within the notch under the Second Act, but those corporations whose normal-tax net incomes are in the range from $31,964.31 to $38,565.89, inclusive, are within the notch under the Second Act and outside the notch under the Act. When these preliminary facts are kept in mind, the computation of the tax becomes relatively simple.

(1) In the case of corporations with normal-tax net incomes in excess of $25,000 but not in excess of $31,964.30, the tax is computed as follows:

(a) The normal-tax computed under the alternative-tax provision of the Second Act is $3,775 (this being the normal tax on the first $25,000 of normal-tax net income) plus thirty-five per cent of the normal-tax net income in excess of $25,000.

(b) The defense tax computed under the Act is ten per cent of $3,775, or $377.50, plus 3.3 per cent of the normal-tax net income in excess of $25,000. The figure of 3.3 per cent represents ten per cent of the thirty-three per cent rate which is the alternative-tax rate of the Act applicable to the normal-tax net income in excess of $25,000.

When these figures are consolidated, it will be found that the
(2) In the case of corporations whose normal-tax net incomes exceed $31,964.30 but do not exceed $38,565.89, the tax is computed as follows:

(a) The normal tax computed under the alternative-tax provision of the Second Act is $3,775 plus thirty-five per cent of the normal-tax net income in excess of $25,000.

(b) The defense tax computed under the Act is 1.9 per cent of the first $25,000 of normal-tax net income, or $475, plus 1.9 per cent of the normal-tax net income in excess of $25,000. It will be noted that these corporations are not within the alternative-tax provision of the Act; hence the normal tax of nineteen per cent prescribed by that Act would have been applicable to their entire normal-tax net income, and the defense tax is ten per cent of that rate, or 1.9 per cent.

When these figures are consolidated, it will be found that the tax of corporations in this group is $4,250 ($3,775 plus $475) plus 36.9 per cent (35 plus 1.9) of the normal-tax net income in excess of $25,000.

For those corporations whose normal-tax net incomes exceed $38,565.89 there is, of course, no problem. Their normal tax under the Second Act is 22.1 per cent of such income, and their defense tax under the Act is 1.9 per cent, giving a consolidated rate of twenty-four per cent.

Section 202 of the Act makes the defense tax applicable to income of non-resident foreign corporations taxable under section 231(a), which means that the applicable rate becomes sixteen and one-half instead of fifteen per cent. Section 144 is also amended to provide for withholding of this tax at the source at the sixteen and one-half per cent rate on or after June 26, 1940. This increase in rate of tax is specifically made non-applicable where it would be contrary to treaty obligations of the United States, which means, concretely, that Canadian corporations will continue to pay only five per cent on dividends and Swedish corporations ten per cent, by virtue of the Canadian and Swedish tax treaties.

Section 203 of the Act makes the defense tax of ten per cent applicable to the surtax imposed by section 500 on personal holding companies. The defense tax, under section 201 of the Act, is likewise
applicable to the surtax imposed by section 102 on corporations improperly accumulating surplus.

Section 204 of the Act, amending section 600, makes the defense tax applicable to the excess-profits tax imposed by that section. This is the excess-profits tax which is a companion to the capital stock tax on declared value. The result of this amendment is to raise the rate from six to 6.6 per cent on the net income in excess of ten per cent but less than fifteen per cent of the declared value of the capital stock, and from twelve to 13.2 per cent on the net income in excess of fifteen per cent of such declared value. It may be noted in passing that section 506 of the Second Act changes the name of this tax, effective February 10, 1939, from "Excess-Profits Tax" to "Declared Value Excess-Profits Tax".

In the case of all the foregoing income taxes, the defense tax applies to any taxable year beginning after December 31, 1939, and before January 1, 1945. The defense tax amendments to sections 143 and 144, relating to withholding of tax at the source, however, apply only to the period after June 25, 1940, and before January 1, 1945.

Excise Taxes.—Section 205 of the Act amends section 1200, which imposes the capital stock tax based on declared and adjusted declared value, so as to increase the rate per thousand dollars of such value from $1.00 to $1.10 for the year ending June 30, 1940, and for the four succeeding years ending June 30.

Section 206 of the Act amends chapter 3 of the Internal Revenue Code (the federal estate tax) by adding a new subchapter "C" and a new section, 951, which increase the amount of tax payable, in the case of a decedent dying after the date of enactment of the Act, and before the expiration of five years after such date, by ten per cent of the amount which would be payable if computed without regard to such section. For the purposes of the section, the tax computed without regard to such section is such tax after the application of the credits provided by section 813 and section 936, that is, the credit for gift tax and the credit for estate, succession, legacy, and inheritance taxes.18

Section 207 of the Act amends section 1001, imposing the gift tax, so as to increase the amount of tax otherwise payable, for the

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18 It will be noted that this estate tax provision is the reverse of the provision prescribed in the case of income taxes, where the defense tax is based upon the income tax computed before the application of the statutory foreign-tax credit and the credit for taxes withheld at the source.
The Revenue Act of 1940

Calendar years 1941 to 1945, inclusive, on account of the aggregate sum of net gifts made during each of such calendar years by ten per cent. The amount of gift tax payable, including the defense tax, is an amount equal to the excess of

(A) 110 per cent of a tax computed in accordance with the rate schedule, on the aggregate sum of the net gifts for the calendar year for which a return is made and for each of the preceding calendar years, over

(B) 110 per cent of a tax, computed in accordance with the rate schedule, on the aggregate sum of the net gifts for each of the preceding calendar years.

For the calendar year 1940, a special provision was necessary in order to avoid application of the increase in tax to gifts made between January 1, 1940, and the date of enactment of the Act and to assure its application to gifts made after the enactment date and prior to January 1, 1941. The desired result was accomplished by providing that a defense tax should first be computed at ten per cent on the entire gift tax for such year otherwise computed, and that the defense tax payable should be a pro rata portion of such ten per cent in accordance with the ratio of taxable gifts made after the enactment date (June 25, 1940) to those made during the entire year. To illustrate, let us assume that X has made gifts during 1940 on which the gift tax computed without regard to the defense tax is $2,000. Let us further assume that one-fourth of the taxable gifts for 1940, in point of value, were made on or before June 25, 1940, and three-fourths after that date. The defense tax payable for 1940 would be three-fourths of ten per cent of $2,000, or $150, and the total gift tax for 1940 would be $2,150. It will be noted that the defense tax, in the case of the gift tax, will be in effect for slightly more than five and a half calendar years.

Section 208 of the Act amended section 1250, imposing a special excise tax on transfers of stock or securities by citizens or residents of the United States, or by domestic corporations or partnerships, or by a trust which is a foreign trust, to a foreign corporation as paid-in surplus or as a contribution to capital, or to a foreign partnership or trust, by increasing the rate of such tax from twenty-five to twenty-seven and a half per cent. The increased rate was made applicable to such transfers made after the date of enactment of the Act and before July 1, 1945, a period of a few days over five years.
The remaining defense taxes relate to miscellaneous excise taxes. Section 210 of the Act amends the Internal Revenue Code by adding a new chapter 9A, entitled "Defense Tax for Five Years". It is provided that, in lieu of the rates of tax specified in such of the sections of the title as are set forth in a table, the rates applicable with respect to the period after June 30, 1940, and before July 1, 1945, shall be the rates set forth under the heading "Defense Tax Rate". In the interest of economy of space, these changes in rate will not, with one or two exceptions, be commented upon individually, since the table in question is reprinted in the footnote. It will be noted that, while in most cases the defense tax rate is 110 per cent of the old rate, there are significant exceptions, where the increase in rate is substantially greater. For instance, the rate on gasoline is increased from one cent to one and a half cents per gallon, an increase of fifty per cent. This one change is estimated to produce an additional annual revenue of 112 million dollars.

<table>
<thead>
<tr>
<th>Section</th>
<th>Description of tax</th>
<th>Old rate</th>
<th>Defense-tax rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1700 (b)</td>
<td>Box seats</td>
<td>10 percent</td>
<td>11 percent</td>
</tr>
<tr>
<td>1700 (c)</td>
<td>Sales outside box office</td>
<td>10 percent</td>
<td>11 percent</td>
</tr>
<tr>
<td>1700 (e)</td>
<td>Cabaret</td>
<td>15 cents</td>
<td>2 cents</td>
</tr>
<tr>
<td>1710 (a) (1)</td>
<td>Dues</td>
<td>10 percent</td>
<td>11 percent</td>
</tr>
<tr>
<td>1710 (a) (2)</td>
<td>Initiation fees</td>
<td>10 percent</td>
<td>11 percent</td>
</tr>
<tr>
<td>1801</td>
<td>Corporate securities</td>
<td>10 cents</td>
<td>11 cents</td>
</tr>
<tr>
<td>1802 (a)</td>
<td>Capital stock issues</td>
<td>2 cents</td>
<td>3 cents</td>
</tr>
<tr>
<td>1802 (b)</td>
<td>Capital stock transfers</td>
<td>4 cents</td>
<td>5 cents</td>
</tr>
<tr>
<td>1802 (b) (f)</td>
<td>Capital stock transfers</td>
<td>5 cents</td>
<td>6 cents</td>
</tr>
<tr>
<td>1804 (a)</td>
<td>Insurance policies</td>
<td>4 cents</td>
<td>5 cents</td>
</tr>
<tr>
<td>1806</td>
<td>Passage tickets</td>
<td>10 percent</td>
<td>11 percent</td>
</tr>
<tr>
<td>1807</td>
<td>Passage tickets</td>
<td>10 percent</td>
<td>11 percent</td>
</tr>
<tr>
<td>1808</td>
<td>Passage tickets</td>
<td>10 percent</td>
<td>11 percent</td>
</tr>
<tr>
<td>1850 (a)</td>
<td>Safe-deposit boxes</td>
<td>$100</td>
<td>$110</td>
</tr>
<tr>
<td>2700 (a)</td>
<td>Pistols and revolvers</td>
<td>$100</td>
<td>$110</td>
</tr>
<tr>
<td>3250 (a) (1)</td>
<td>Wholesalers in liquor</td>
<td>$100</td>
<td>$110</td>
</tr>
<tr>
<td>3250 (b)</td>
<td>Wholesalers in liquor</td>
<td>$100</td>
<td>$110</td>
</tr>
<tr>
<td>3250 (c)</td>
<td>Brewers</td>
<td>$50</td>
<td>$55</td>
</tr>
<tr>
<td>3250 (d)</td>
<td>Brewers</td>
<td>$50</td>
<td>$55</td>
</tr>
<tr>
<td>3250 (e)</td>
<td>Retailers</td>
<td>$20</td>
<td>$25</td>
</tr>
<tr>
<td>3250 (e) (3)</td>
<td>Special cases</td>
<td>$2</td>
<td>$2.20</td>
</tr>
<tr>
<td>3250 (f) (1)</td>
<td>Retailers</td>
<td>$50</td>
<td>$55</td>
</tr>
<tr>
<td>3250 (f) (2)</td>
<td>Retailers</td>
<td>$100</td>
<td>$110</td>
</tr>
<tr>
<td>3250 (j)</td>
<td>Stills</td>
<td>$20</td>
<td>$22</td>
</tr>
<tr>
<td>3250 (j)</td>
<td>Stills</td>
<td>$20</td>
<td>$22</td>
</tr>
<tr>
<td>3400 (1)</td>
<td>Automobile truck chassis, etc</td>
<td>10 percent</td>
<td>11 percent</td>
</tr>
<tr>
<td>3400 (2)</td>
<td>Tubes</td>
<td>3 cents</td>
<td>3½ cents</td>
</tr>
<tr>
<td>3401</td>
<td>Toilet preparations</td>
<td>2 percent</td>
<td>2½ percent</td>
</tr>
<tr>
<td>3402 (a)</td>
<td>Automobile, etc.</td>
<td>2 percent</td>
<td>2½ percent</td>
</tr>
<tr>
<td>3402 (b)</td>
<td>Automobiles, etc.</td>
<td>3 percent</td>
<td>3½ percent</td>
</tr>
<tr>
<td>3403 (c)</td>
<td>Parts</td>
<td>2 percent</td>
<td>2½ percent</td>
</tr>
<tr>
<td>3404</td>
<td>Radios</td>
<td>5 percent</td>
<td>5½ percent</td>
</tr>
<tr>
<td>3405</td>
<td>Mechanical refrigerators</td>
<td>5 percent</td>
<td>5½ percent</td>
</tr>
<tr>
<td>3407</td>
<td>Firearms</td>
<td>10 percent</td>
<td>11 percent</td>
</tr>
<tr>
<td>3409</td>
<td>Matches</td>
<td>3 cents</td>
<td>3½ cents</td>
</tr>
<tr>
<td>3410</td>
<td>Electrical energy</td>
<td>1 cent</td>
<td>1½ cents</td>
</tr>
<tr>
<td>3412</td>
<td>Gasoline</td>
<td>4 cents</td>
<td>4½ cents</td>
</tr>
<tr>
<td>3413</td>
<td>Lubricating oils</td>
<td>5 cents</td>
<td>5½ cents</td>
</tr>
<tr>
<td>3460 (a) (1), (2), and (3)</td>
<td>Transportation of oil</td>
<td>4 percent</td>
<td>4½ percent</td>
</tr>
<tr>
<td>3481 (a)</td>
<td>Transfer bonds</td>
<td>5 cents</td>
<td>5½ cents</td>
</tr>
<tr>
<td>3482</td>
<td>Conveyances</td>
<td>50 cents</td>
<td>55 cents</td>
</tr>
</tbody>
</table>

* Increase in tax is other than ten percent.
Section 1650(b) of chapter 9A of the Act amended section 3441(c) so as to relieve from the burden of the increased rates articles delivered prior to July 1, 1940, under leases, contracts of sale, or conditional sales made before that date.

It may be noted in passing that the revenue productivity of the excise tax on toilet preparations, imposed by section 3401, was considerably reduced by an amendment made by the Revenue Act of 1939,20 which excluded from the basis of the tax in certain cases the cost of containers and also excluded generally certain other charges, such as advertising costs. The statistics of revenue collections show a drop of between twenty-five and thirty per cent in the collections from this tax in the fiscal year ended June 30, 1940, the first year to which the amendment applied, as compared with the fiscal year ended June 30, 1939. It seems reasonable to attribute this revenue reduction chiefly to the operation of the above amendment.

Section 211 of the Act revised the tax on admissions, imposed by section 1700(a)(1), by amending that section so as to provide in effect that, for the period after June 30, 1940, and before July 1, 1945, with respect to admissions for which the charge is twenty-one cents or more, the tax of one cent for each ten cents or fraction thereof shall apply. Prior to this amendment, no tax was imposed on admissions costing forty cents or less. The result of the amendment is that there is no tax on admissions of twenty cents or less, three cents tax on admissions from twenty-one to thirty cents, four cents tax on admissions from thirty-one to forty cents, five cents tax on admissions from forty-one to fifty cents, and so forth.

Section 212 of the Act increased the rates of tax imposed by section 2000(c)(2) on cigarettes, depending on weight, from $3.00 per thousand and $7.20 per thousand to $3.25 and $7.80 per thousand, respectively. It will be noted the increase in these rates was only 8 1/3 per cent. The other tobacco taxes were not disturbed by the Act. This moderate increase in cigarette taxes is all that remains of provisions in H.R. 10039, as it passed the House, which would have increased the taxes on all tobacco products. The Senate Finance Committee eliminated all increases in tobacco tax rates, asserting in justification for such action that "the tax on tobacco and tobacco products is already very high and that any increase in this tax would

have a tendency to injure the tobacco farmer and decrease the consumption of tobacco products". The Senate followed its Committee's recommendation. The disagreement between the houses was carried to the conference, where the Senate prevailed except for the retention of the foregoing limited increases in the cigarette tax. A floor stocks tax was also imposed on cigarettes subject to tax under section 2000(c), at a rate equal to the defense tax increase, where such cigarettes were held by any person for sale on July 1, 1940, returns to be filed and the tax paid on or before August 1, except that the Commissioner was authorized, except in the case of manufacturers or importers, to collect the tax by stamp.

It is rather difficult to understand why, in the enactment of a revenue act in a serious fiscal emergency, an act which plows so deep and increases almost all other important taxes, tobacco products should be permitted to escape bearing a share of the increased tax load. Of course, as the Finance Committee states, tobacco taxes are already high, but so are most other taxes. In the absence of a showing that taxes on tobacco are so high that further increase would pass the point of diminishing returns and cause net loss rather than gain in revenue, it is difficult to defend this feature of the Act.

Distilled spirits, wines, and fermented malt liquors did not escape so easily. Section 213 of the Act increased the rates of tax with respect to the period after June 30, 1940, and before July 1, 1945, from $2.25 to $3.00 per proof gallon on distilled spirits generally, $2.00 to $2.75 on brandy, and $2.25 to $3.00 on imported perfumes. A floor stocks tax of seventy-five cents per proof gallon was also imposed on all stocks held and intended for sale or for use in manufacture or production of any article intended for sale on July 1, 1940, with an exemption of 100 proof gallons in favor of retail dealers incurring occupation tax for the period beginning July 1, 1940. Returns had to be filed and the tax paid on or before August 1. Such returns were required from retail dealers, even though not liable to the tax. The drawback provision of section 2887, third paragraph, was amended to accord with the above increases in rate.

Section 214 of the Act amended chapter 26 by adding a new subchapter "F". This amendment, for the five-year period from July 1, 1940, to June 30, 1945, increased the rates of tax on still wines, sparkling wines, liquors and cordials, in the manner shown in the

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21 See Report No. 1856 of Senate Finance Committee on H. R. 10039, 76th Cong. (June 15, 1940) at 1.
table in the footnote,\textsuperscript{22} and increased the tax imposed on fermented malt liquors by section 3150(a) from $5.00 to $6.00 per barrel. A floor stocks tax of $1.00 per barrel was also imposed on fermented malt liquors, as of July 1, 1940, with an exemption of retail stocks held by a person on premises as to which such person had incurred occupational tax as a retail dealer for the period beginning July 1, 1940. Returns had to be filed and the tax paid on or before August 1.

With respect to the taxes on certain wines, it should be noted that the rates had already been substantially increased by an act\textsuperscript{23} enacted on June 24, 1940. That act also repealed the tax of ten cents per gallon imposed on brandy withdrawn for fortification of wines, theretofore imposed by section 3031. Further increases in these taxes were made by section 214 as a defense tax. No change was made in the additional tax on rectification of wines and distilled spirits, imposed by section 2800(a)(5).

Section 215 of the Act amended section 1807, imposing a tax on playing cards, so as to increase the rate of tax for the period after June 30, 1940, and before July 1, 1945, from ten cents per pack to eleven cents per pack.

Section 216 of the Act amended section 3403(e), relating to credits on tax on automobiles, and so forth, so as to provide that the rates of credit during the five-year period in which the defense tax rate applies should be increased from two and three per cent to two and a half and three and a half per cent, respectively.

It will be seen that there are a few taxes in the federal revenue system which have not been increased by the Act. Most important of these are the various payroll taxes levied under the social security acts, the proceeds of which are intended to be used for special and limited purposes. No increases were made in the various regulatory taxes, unimportant as revenue producers, such as the taxes on mixed flour, narcotics, sugar, bituminous coal, filled cheese, certain firearms, and white phosphorous matches, nor in the so-called excises on certain import articles, which are really disguised tariffs, such

\begin{table}[h]
\centering
\begin{tabular}{|c|c|c|c|}
\hline
Section & Description of tax & Old rate & Defense-tax rate \\
\hline
3030 (a) (1) (A) & Still wines & 5 cents & 6 cents \\
3030 (a) (1) (A) & Still wines & 15 cents & 16 cents \\
3030 (a) (1) (A) & Still wines & 25 cents & 30 cents \\
3030 (a) (2) & Sparkling wines & 2½ cents & 3 cents \\
3030 (a) (2) & Sparkling wines & 1½ cents & 1½ cents \\
3030 (a) (2) & Liqueurs, cordials, etc. & 1¼ cents & 1½ cents \\
3150 (a) & Fermented malt liquors & $5 & $6 \\
\hline
\end{tabular}
\caption{Tax rates before and after the Revenue Act of 1940.}
\end{table}

\textsuperscript{22} Pub. L. No. 655, 76th Cong. (June 24, 1940).
as the taxes imposed with respect to certain vegetable oils, copper, coal, lumber, and petroleum products. Also, for administrative reasons, the excise taxes on telephone, telegraph, cable, and radio were not disturbed. Finally, the special tax imposed by section 1805 on gainful transfers of interests in silver bullion was not changed. The Senate Finance Committee recommended the repeal of this tax, but the repealing amendment was eliminated in conference.

Title IV, section 401, of the Act amended section 205 of the Public Salary Tax Act of 1939 so as to relieve certain officers and employees of states, and political subdivisions or instrumentalities thereof, from criminal penalties and from the additions to tax provided in sections 291 and 293 on account of failure to make return of such compensation or pay deficiencies in income tax on account thereof, provided payment of the delinquent tax is made on or before March 15, 1941.

The President's recent annual message to the Congress has served to emphasize anew the terrific cost of the defense program, including new forms of aid to the democracies at war and has recognized that the situation obviously demands further heavy increases in taxes. It seems safe to assume that Congress will seek to raise a minimum of from one to one and one-half billion additional tax dollars at this session. Just how this will be done it is difficult to foresee in detail, but it seems reasonably certain that reliance will be placed upon increases in the so-called "ability to pay" taxes for a large part of the new revenue. This means that further increases in personal income tax rates, including a heavy boost in the normal rate which for years has remained at four per cent, in the corporation income tax rates, and possibly the gift and estate tax rates, with possible downward revision of various exemptions, may be looked for. In any event, it has become crystal clear that the revenue acts of 1940 were but a prelude and that heavily increased tax burdens for all for many years to come are a certainty.