See page 839 for what Congress references in footnote 168 of the committee report.

Note that the 1944 law added the concept of AGI.

# COMMITTEE REPORTS.

1944–11–11756

## INDIVIDUAL INCOME TAX BILL OF 1944.

[House of Representatives Report No. 1365, Seventy-eighth Congress, Second Session.]

[April 24, 1944.]

Mr. Doughton, from the Committee on Ways and Means, submitted the following report [to accompany H. R. 4646]:

The Committee on Ways and Means, to whom was referred the bill (H. R. 4646) to provide for simplification of the individual income tax, having had the same under consideration, report it back to the House without amendment and recommend that the bill do pass.

The bill is confined to the simplification of the individual income tax. In the preparation of this legislation your committee had in mind the following objectives:

1. To relieve the great majority of taxpayers from the necessity of computing their income tax.
2. To reduce the number of tax computations.
3. To simplify the return form.
4. To decrease the number of persons required to file declarations of estimated tax.
5. To eliminate some of the difficulties and uncertainties in the making of estimates required for declarations.

The bill accomplishes these objectives without substantially changing the number of taxpayers or the revenue yield under existing law.

## SUMMARY OF CHANGES IN EXISTING LAW.

To accomplish these objectives, the bill makes several important changes in existing law.

First, for the surtax, there is a uniform exemption of $500 per person. Thus the taxpayer is allowed $500, the taxpayer's spouse is allowed $500, and there is a $500 allowance for each dependent.

Second, the victory tax is repealed. The present normal tax and surtax are combined into a single surtax. A new normal tax of 3 per cent is imposed on each person whose net income exceeds $500.

Third, a new simplified tax table, designated Supplement T, is provided in the bill. This table may be used by taxpayers with adjusted gross incomes of less than $5,000, regardless of the source of their income. In general, adjusted gross income is gross income less business deductions. The table is so constructed as to allow the taxpayer a standard deduction of approximately 10 per cent of his gross income. The use of this table is optional with the taxpayer.

Fourth, taxpayers with adjusted gross incomes of $5,000 or more are permitted at their option to claim, in lieu of their actual deductions, a standard deduction of $500.

Fifth, the present withholding system is modified, effective with respect to wages paid on or after January 1, 1945, so as to withhold, in the case of a taxpayer whose income is derived solely from wages, approximately the full tax liability on wages up to at least $5,000.

Sixth, in this bill taxpayers filing declarations are given an opportunity to amend their declarations on or before January 15 next following the close of the taxable year, for those on a calendar-year basis. Taxpayers may file, on or before January 15, their final return in lieu of the final declaration of estimated tax. Under present law, the final amended declaration must be filed on or before December 15.

Seventh, the bill makes two important changes with reference to farmers. A farmer is defined under the bill as an individual who derives more than two-thirds of his gross income from farming. Under existing law, an individual is not classified as a farmer unless he derives 80 per cent or more of his gross income from farming. The other important change is that, under the bill, a farmer may make a final return on or before January 15 next following the close of the calendar year in lieu of making any declaration of estimated tax. If he is unable to make a complete return by January 15 he can make a declaration of an estimated tax on or before January 15, and file a final return on or before March 15. Under present law, a farmer is required to file a declaration of estimated tax on or before December 15 of the current year.

Eighth, the number of individuals required to file declarations of estimated tax is considerably decreased by the bill.

Under this bill those whose income not subject to withholding does not exceed $100 are required to file declarations only if their gross income exceeds $5,000, plus $500 for the spouse, and $500 for each dependent. Under present law, a declaration is required for those whose "other" income does not exceed $100 if their gross income from wages is over $2,700, if single, or $3,500 if married.

Ninth, the existing law has been amended with respect to deductions for charitable contributions so as to allow up to 15 per cent of the adjusted gross income (generally, gross income less business deductions) in lieu of the present law limit of 15 per cent of net income. This has the effect of increasing the allowance for charitable contributions, and will enable the taxpayer to compute his charitable deduction without having to determine his net income.

Tenth, under the bill medical expenses are deductible only to the extent that they exceed 5 per cent of adjusted gross income in lieu of the present law provision of 5 per cent of net income computed without regard to this deduction. This will result in a slight reduction in the medical expense allowance but is believed justified in the interest of simplification.

Eleventh, the bill introduces a new concept, adjusted gross income. It is defined to mean gross income less business deductions, deductions attributable to rents and royalties, and losses treated as losses from the exchange or sale of property. In the case of an employee, adjusted gross income consists of gross wages or salary less expenses of travel or lodging in connection with employment while away from home, and any reimbursed expenses in connection with his employment. It will be seen, therefore, that in general adjusted gross income means gross income less business deductions.

### Operation of Plan.

For purposes of discussion, taxpayers are divided into two groups, namely:

(1) Those who qualify and elect to have the collector of internal revenue determine their tax, and

(2) Those who determine their own tax.

Each group is discussed separately.

#### (1) TAXPAYERS FOR WHOM THE COLLECTOR DETERMINES THE TAX.

Individuals whose gross income is less than $5,000 and whose income from sources other than wages subject to withholding does not exceed $100, may at their option have their tax determined by the collector, if their income is received from certain sources. To be entitled to this option, their entire income must be derived from dividends, interest, and compensation for personal services. It is contemplated that the form to be used for this purpose, in lieu of the regular tax return, will be the withholding tax receipt furnished by their employer.

If the wage earner uses this receipt, he will have to answer only a few questions on the reverse side, list the names of his dependents, and attach all other receipts which he or his spouse may have been furnished. The questions will probably require stating the number of withholding receipts attached, the total amount of wages and tax withheld as shown on the receipts, and the amount of other income, if any. The taxpayer will sign a statement on the receipt affirming the correctness of the statements in the return, and stating that his entire income was reported on the receipt.

The collector will determine the tax, using for this purpose the tax table which automatically allows a standard deduction. If any additional tax is due, a bill will be sent by the collector, which must be paid in 30 days. If

law prevails to the effect that the parent is entitled to the services of the child and hence is entitled to his earnings. This rule is subject to numerous exceptions depending on the circumstances and, in many cases, the intent of the parties. In Louisiana, where the legal system stems from the French civil law, the parent has no right to the services of his child. Thus, for Federal income tax purposes, opposite results may obtain under the same set of facts depending upon the applicable State law. In addition, such variations in the facts as make applicable the exceptions to the general rule in each jurisdiction tend to produce additional uncertainty with respect to the tax treatment of the earnings of minor children. Section 7 of the bill incorporates a policy which will make for uniformity among the various States in taxation of the compensation for services performed by a minor child.

Subsection (a) of this section states the rule with respect to inclusion in gross income of the amounts received for the child's services. It amends section 22 (relating to gross income) to provide that such amounts shall be included in the gross income of the child. This is so even though the compensation is not received by the child. As a corollary it is provided that such amounts shall not be included in the gross income of the parent. Thus, even though the contract of employment is made directly by the parent and the parent receives the compensation for the services, for the purposes of the Federal income tax, the amounts would be considered to be taxable to the child because earned by him. This subsection likewise provides that expenditures whether made by the parent or the child, which are attributable to the earnings of the child, shall be considered to have been paid or incurred by him. Thus, for the purposes of the Federal income tax, regardless of the provisions of the local law, the child is deemed to be a separate taxpayer subject to the filing requirements as is any other taxpayer, entitled to a separate exemption for normal tax and surtax, and entitled to take as deductions the amounts paid out by him or on his behalf where the amounts are attributable to his earnings and are otherwise deductible from gross income for tax purposes. Under this provision, a child would be entitled to take as deductions not only expenditures made on his behalf by his parent which would commonly be considered as business expenses, but also such personal deductions as were made out of his earnings and in his name. For example, a contribution made by a parent in the name of a juvenile actor and out of his earnings to a charitable organization for indigent members of the acting profession would be deductible on the return of the child.

Under these provisions, it is contemplated that the parent or guardian of the child will cause to be made and filed, and will execute on behalf of the child, the required return where the child himself is unable to do so. The term "parent" is defined to mean, in this connection, an individual who under local law is entitled to the services of the child by reason of having parental rights and duties in respect of the child.

The policy of taxing compensation earned by a child to such child contemplates that the tax will be payable out of or charged upon such compensation. This result follows automatically to the extent the tax is withheld. With respect to any tax liability not satisfied through withholding, which is attributable to such compensation, the amendment provides that the parent is to be treated as having the rights and duties of a fiduciary, to the extent of his rights and privileges over such income. Though it is explicitly provided that the parent shall be considered as acting in a fiduciary capacity in cases where the income includible in the gross income of the child solely by reason of this section, this provision does not affect or relieve the parent or guardian from any existing liability.

SECTION 8. ADJUSTED GROSS INCOME.

Subsection (a) of this section amends section 22 of the Code by adding subsection (n) thereto for the purpose of defining the new concept "Adjusted gross income," which is used in determining the tax under Supplement T. The tax table provided in section 400 is divided into brackets representing amounts of adjusted gross income. Adjusted gross income also constitutes the base which determines whether the optional standard deduction of $500, as provided in section 9 of the bill, is applicable. The proposed section 22(n) of the Code provides that the term "adjusted gross income" shall mean the gross income computed under section 22 less the sum of the following deductions: (1) Deductions allowable under section 23 of the Code, which are attributable to a trade or business carried on by the taxpayer not consisting of services performed as an employee; (2) deductions allowed by section 23 which constitute expenses

of travel, meals, and lodging paid or incurred by the taxpayer while away from home in connection with the performance by him of services as an employee; (3) deductions allowed by section 23 (other than expenses of travel, meals, and lodging while away from home) which consist of expenses paid or incurred in connection with the performance of services as an employee under a reimbursement or other expense-allowance arrangement with his employer; (4) deductions allowable under section 23 which are attributable to rents and royalties; (5) deductions not included in the deductions before mentioned, for depreciation and depletion allowed under section 23 (l) and (m) to a life tenant of property or to an income beneficiary of property held in trust; and (6) deductions (other than those which would be considered business losses) which are allowed by section 23 as losses from the sale or exchange of property. In the usual case, therefore, the deductions which are to be made from gross income in arriving at adjusted gross income are limited to certain business expenses and losses which are treated as losses from sales or exchanges of property. Thus taxes and interest are deductible in arriving at adjusted gross income only as they constitute expenditures attributable to a trade or business or to property from which rents or royalties are derived. The connection contemplated in this statute is a direct one rather than a remote one. For example, property taxes paid or incurred on real property used in the trade or business would be deductible, whereas State income taxes, though incurred as a result of business profits, would not be deductible.

This section creates no new deductions; the only deductions permitted are such of those allowed in Chapter 1 of the Code as are specified in any of the clauses (1) to (6) above. The circumstance that a particular item is specified in one of the clauses and is also includible in another does not enable the item to be twice subtracted in determining adjusted gross income.

The only expenses in connection with his employment which are deductible by an employee, as distinguished from an individual entrepreneur, are those which he incurs for travel, meals, and lodging while away from home, or those for which he is reimbursed directly by a separate payment by his employer. Thus, for example, an employee who incurs expenses for his employer for which he is reimbursed or for which he receives a per diem remuneration, would include in his gross income the amount of the per diem or reimbursement but would be entitled to deduct the amounts paid out by him for expenses.

Subsection (b) of this section contains an amendment to section 23(o) of the Code, relating to the deduction for charitable contributions. This section is amended to allow as a deduction from gross income charitable contributions of an individual to the extent that the amount of such contributions does not exceed 15 per cent of the taxpayer's adjusted gross income rather than 15 per cent of the taxpayer's net income computed without the benefit of the deduction. The effect of this amendment is generally to enlarge the amount of tax benefit which may be received by an individual who makes large gifts to charity.

Subsection (c) of this section has a similar amendment to section 23(x) of the Code, relating to the deduction for medical expenses. Here, the effect of substituting adjusted gross income for net income computed without the benefit of the deduction is to increase slightly the amount of the medical expenses which must be incurred before deduction therefor will be allowed. The medical expense deduction provision is also amended to correspond to the system of surtax exemptions which is introduced in section 10 of the bill. Under existing law, the limit to which medical expenses may be deducted is $1,250 in the case of a single person, or a married person filing a separate return, and $2,500 in the case of married persons filing a joint return, or in the case of a head of the family. Since, under section 10 of the bill, the concept of the head of the family is eliminated, the limits upon the deduction are cast in the terms of surtax exemption. Thus, $1,250 is the maximum deduction for the taxable year if only one surtax exemption is allowed to the taxpayer, and $2,500 if more than one surtax exemption is allowed.

### SECTION 9. OPTIONAL STANDARD DEDUCTION.

This section of the bill amends section 23 of the Code to add a new subsection (aa) which provides that certain individual taxpayers may elect to take a standard deduction in lieu of certain deductions and credits.

Paragraph (1) of subsection (aa) provides that the standard deduction is $500 in the case of a taxpayer whose adjusted gross income as defined in section 8 of the bill is $5,000 or more. In respect of a taxpayer who has an adjusted

gross income of less than $5,000, the standard deduction will be available only through the use of the tax table provided in Supplement T. The tax table is so constructed as to compute the tax on the adjusted gross income at the midpoint of the bracket. In arriving at the tax payable for each bracket, there is allowed a standard deduction of 10 per cent of the adjusted gross income at the midpoint of the bracket.

The standard deduction, if elected by the taxpayer, is taken in lieu of all deductions other than those which are to be subtracted from gross income in computing adjusted gross income as defined in section 8 of the bill, and also in lieu of the credits for taxes of foreign countries and possessions of the United States, credits for taxes withheld at the source under section 143(a) of the Code and credits against net income in respect of interest on certain obligations of the United States and Government corporations described in section 25(a) (1) and (2).

In the case of a taxpayer who has elected to amortize bond premiums in accordance with the provisions of section 125, the deduction for the amortizable bond premium under such section is deemed to be allowable for the purposes of section 113(b)(1)(H), relating to the adjusted basis of the bonds, though the taxpayer elects the standard deduction in lieu of such deduction for the amortizable bond premium.

The taxpayer may avail himself of the standard deduction for the taxable year only if he so elects; and if he does elect to take the standard deduction for the taxable year, such election shall be irrevocable for such year. In the case of a taxpayer whose adjusted gross income, as shown on his return, is $5,000 or more, the standard deduction shall be allowed only if he signifies in his return his election to take such standard deduction in the manner to be prescribed by the Commissioner with the approval of the Secretary. If the taxpayer's adjusted gross income, as shown on his return, is less than $5,000, the standard deduction shall be allowed only if he elects to pay the tax imposed by the tax table in Supplement T; his election to pay the tax under Supplement T must be made in accordance with regulations prescribed by the Commissioner, with the approval of the Secretary, under such supplement. If the adjusted gross income shown on the return is $5,000 or more, but the correct amount is less than $5,000, then the election by the taxpayer to take the standard deduction shall be deemed to be his election to pay the tax imposed by Supplement T. Similarly, a failure to elect to take the standard deduction will constitute an election not to pay the tax imposed by Supplement T. On the other hand, if the adjusted gross income shown on the return is under $5,000, but the correct amount is $5,000 or more, then his election to pay the tax imposed by Supplement T shall be considered his election to take the standard deduction; and in a like manner, if he fails to elect to pay the tax imposed by Supplement T, he shall be deemed to have elected not to take the standard deduction.

In the case of a husband and wife living together, if the net income of one spouse is determined without regard to the standard deduction, the other spouse shall not be permitted to avail himself of the standard deduction. For example, if a husband, whose adjusted gross income is shown on his return to be $6,000, does not elect to take the standard deduction of $500, his wife with an adjusted gross income of $3,500 will be precluded from computing her tax in accordance with the tax table prescribed in Supplement T. The determination of whether an individual is married and living with his spouse shall be made as of the last day of the taxable year. If one spouse dies during the taxable year, such determination, however, will be made as of the date on which such death occurred.

The standard deduction is not permitted where a separate return is made for a period of less than 12 months under section 47(a) of the Code on account of a change in the accounting period of the taxpayer.

Subsections (b), (c), and (d) of this section amend sections 162, 169, 183, and 213 of the Code so as to deny to estates, trusts, common trust funds, partnerships, and nonresident aliens and citizens of the United States entitled to the benefits of section 251 the privilege of taking the standard deduction.

SECTION 10. CREDITS AGAINST NET INCOME.

Section 10(a) amends section 25(a) of the Code by adding at the end thereof a new paragraph to provide a normal tax exemption of $500. In the case of a joint return by husband and wife under section 51, a normal tax exemption of