COMMITTEE REPORTS.

INDIVIDUAL INCOME TAX BILL OF 1944.


[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Second, the victory tax is repealed.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 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.
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 be obtained under the same set of facts depending upon the applicable State law. In addition, variances in the legal effects as made 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 includable 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 (p) 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 25 which constitute expenses of travel, meals, etc., from home in the course of employment; (3) deductions allowed under section 26; (4) deductions allowed under section 27; (5) deductions allowed under section 28; and (6) other deductions other than those allowed by section 29.

This section of the Code, relating to division of income, with subsection added thereto, is intended to include in income and to tax in full income from all sources; and to make the tax thereon the same in all cases where the taxable income of a taxpayer is determined under the same law and under the same principles. The effect of this act shall be to remove the inequality in the tax law as to the income of persons and the income of corporations, and to make the tax on incomes alike as far as possible.

This section of the Code, relating to division of income, with subsection added thereto, is intended to include in income and to tax in full income from all sources; and to make the tax thereon the same in all cases where the taxable income of a taxpayer is determined under the same law and under the same principles. The effect of this act shall be to remove the inequality in the tax law as to the income of persons and the income of corporations, and to make the tax on incomes alike as far as possible.

685523 - 45
of travel, meals, and lodging paid or incurred by the taxpayer while away from home in connection with the performance by him or her 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 reimbursed or other expense-allowance arrangement with his or her employer; (4) deductions allowable under section 23 which are attributable to rents and depreciation and depletion allowed under section 23 (1) and (m) to a life tenant whose deductions (other than those which would be considered business losses) which the usual case, therefore, the deductions which are to be made from gross income and losses which are treated as losses from sales or exchanges of property, taxes and interest are deductible in arriving at adjusted gross income; (5) property taxes paid or incurred on real property used in the trade or business; (6) deductions paid or incurred as a result of business profits, would not be deductible.

This section creates no new deductions; the only deductions permitted are those allowed in Chapter 1 of the Code as are specified in any of the clauses (1) to (6) above. The circumstances 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 or her employment which are deductible by an employee, as distinguished from an individual entrepreneur, are those which he or she incurs for travel, meals, and lodging while away from home, or for which he is reimbursed directly by the separate payment by his or her 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(a) 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 percent of the taxpayer's adjusted gross income rather than 15 percent 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(a) of the Code, relating to the deduction for medical expenses. Here, the effect of the subsection (b) of this section is that the adjusted gross income for net income computed without the benefit of the deduction is to increase slightly the amount of the medical expenses which are deductible before deduction therefor will be allowed. The medical expense must be incurred before deduction therefor will be allowed. The medical expense deduction provision is also amended to correspond to the system of surtax deduction provision in section 10 of the bill. Under existing law, deductions which are introduced in section 10 of the bill, the limits upon the deduction are cast in the terms of surtax exemption limits where the limits upon the deduction are cast in the terms of surtax exemption limits. In the case of a married person filing a separate return, and $2,500 in the case of a single person, or a married person filing a joint return, or in the case of a head of the family. To the extent that the amount of medical expenses which are deductible before deduction therefor will be allowed, the limits upon the deduction are cast in the terms of surtax exemption limits. In the case of a married person filing a separate return, and $2,500 in the case of a single person, or a married person filing a joint return, or in the case of a head of the family. To the extent that the amount of medical expenses which are deductible before deduction therefor will be allowed, the limits upon the deduction are cast in the terms of surtax exemption limits.

SECTION 9. OPTIONAL STANDARD DEDUCTION.

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 $5,000 in the case of a taxpayer whose adjusted gross income as defined in section 669 of the bill is $5,000 or more. In respect of a taxpayer who has an adjusted gross income of $15,000 or more.
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. Deductions for taxes of foreign countries and possessions of the United States, credits for taxes withheld at the source under section 12, and the credits for the purposes of the subchapter of the Code which are against interest on obligations of the United States and Government corporations are described in sections 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 section 260 is to be allowable for the purposes of section 113(b)(1). The deduction for the bonds, though not a standard deduction in the sense of section 260, is to be taxable to the taxpayer under section 260.

The taxpayer may avail himself of the standard deduction for the taxable year only if he does elect to take the standard deduction, for the taxable year, such election being irrevocable for such year. In the case of a taxpayer whose adjusted gross income, as shown on his return, is $3,000 or more, the standard deduction shall be allowed only if he is a native of the United States, as 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 $3,000, 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 the regulations prescribed by the Commissioner, with the approval of the Secretary, under such supplement. For the purposes of this section, the term "adjusted gross income" means the amount shown on the return, but the correct amount if less than $3,000, then by the election of 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 taxpayer's adjusted gross income shown on his return is $3,000 or more, and on the other hand, 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 either event, whose adjusted dependent is related to the taxpayer within one of the following relationships: child, the descendant of such child: a stepchild; a brother, sister, or half-sibling of the taxpayer; a brother or sister of the taxpayer; a parent, stepfather or stepmother of the taxpayer; an uncle or aunt of the taxpayer; a father-in-law, mother-in-law, brother-in-law, or sister-in-law. For the purposes of determining whether any of the above relationships exist a legally adopted child is considered a child by blood.

It is contemplated by the bill that not more than one taxpayer shall be entitled to a surtax exemption with respect to any individual. Consistent with this theory, an additional restriction on the claiming of the tax is provided. A temporary reduction of the amount of the surtax exemption shall be made for any individual who has, during the taxable year, a gross income of $500 or more. Such an individual is, under section 51 of the Code, required to file a return and would be entitled to the surtax exemption in his own behalf. This rule applies even though the individual in question derives more than one-half of his support from the taxpayer, and, in the case of a minor child earning $1,000 of income during the taxable year, a return must be filed by the child and no credit is allowed the parent even though the child receives more than one-half of the credit for the taxable year from the parent. Likewise, a father having gross income of $500 or more

1. $1,000 is provided except that where the adjusted gross income of one spouse is greater than that of the other, the amount of the exemption shall be $500.