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COMMITTEE REPORTS.

INDIVIDUAL INCOME TAX BILL OF 1944. 1944-11-11756

[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Second, the victory tax is repealed.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.

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.

See the last part of this paragraph for what is referenced in the TCJA House Rpt at footnote 168.

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

Included for historical
interest of the 1944 legislation;
key part is on page 839.

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

$1,000 is provided except that where the adjusted gross income of one spouse is less than $500, the exemption will be $500 plus the adjusted gross income of such spouse. For the purposes of the normal tax, no credit or exemption is recognized with respect to dependents.

Section 10(b) revises subsection (b) of section 25 of the Code to eliminate references now found therein to husband and wife, and to head of a family, and to provide for surtax exemptions on a per capita system. As a feature of the per capita exemption system the amendment also changes existing law tests for credit for dependents. Under the new provisions a taxpayer may receive credits against net income for the purposes of the surtax, but not for the normal tax, in the amount of $500 for himself, $500 for his spouse if a joint return is filed or if a separate return is filed and the spouse has no gross income and is not a dependent of another person, and $500 for each dependent whose gross income is less than $500. Thus where a husband and wife file a joint return they are entitled to an exemption of $1,000. In such case neither the husband nor the wife may be claimed as a dependent by any other person. This is true although the wife, for instance, has no gross income and has received more than half of her support for the taxable year from her parent. In the husband and wife situation where no joint return is filed but where one of the spouses files a separate return, such spouse would be entitled to claim an exemption of $1,000 provided that the other spouse had no gross income and was not a dependent of another person. The rule under existing law that the marital exemption may be divided between the spouses as they choose or all claimed by one spouse on a separate return, is changed so that where separate returns are filed, husband and wife are entitled only to their respective $500 exemptions. It is only in the case where one spouse has no gross income and is not a dependent of another person that the other spouse (having no dependents) may claim $1,000 on a separate return filed by him. Similarly, it is only in the situation where a separate return is filed by one spouse and the other spouse has no gross income that inquiry need be made into the question of whether the wife for example, is supported by her parent. However, if the wife, for instance, had no gross income and derived more than half of her support from an individual who would not be entitled to claim a credit for her as a dependent (for example, a first cousin), the husband would be entitled to the surtax exemption with respect to his wife.

In addition to the exemption of the taxpayer himself and the possible second exemption for his spouse under the conditions noted above, a taxpayer is entitled, under the new section, to a $500 exemption for each dependent. Under existing law a taxpayer may claim a credit for any person who is dependent on him and is under the age of 18 or physically or mentally incapable of self-support, and for whom he furnishes the chief support. In lieu of these tests the new system of exemptions grants a surtax exemption for every person closely related to the taxpayer in any of several specified degrees of relationship for whom the taxpayer provides over half the support. In addition, it is provided that the term "dependent" does not include any nonresident alien individual unless such individual is a resident of a country contiguous to the United States.

It is required that the dependent be related to the taxpayer within one of the following relationships; child, the descendants of such child; a stepchild; a brother, sister, or brother or sister by the half-blood, stepbrother or stepsister; parent, or grandparent; a stepfather or stepmother; a niece or nephew; an uncle or aunt; a son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law. For the purpose of determining whether any of the foregoing relationships exist a legally adopted child is considered as 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 surtax exemption for a dependent is found in the fact that such exemption may not be claimed 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, as amended by section 11 of the bill, required to file a return and would be entitled to the surtax exemption on his own behalf. This rule applies even though the individual in question derives more than one-half of his support from the taxpayer. Thus in the case of a minor child earning wages of $600 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 his support for the taxable year from the parent. Likewise, a father having gross income of $500 or more

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