

# Eisenhower Would Revise 'Our Whole System of Taxation'

WASHINGTON, Jan. 21 (AP)—Following is the complete text of the tax proposals set forth by President Eisenhower in his budget message to Congress today.

Our whole system of taxation needs revision and overhauling. It has grown haphazardly over many years. The tax system should be completely revised.

Revision of the tax system is needed to make tax burdens fairer for millions of individual taxpayers. It is needed to restore normal incentives for sustained production and economic growth. The country's economy has continued to grow during recent years with artificial support from recurring inflation. This is not a solid foundation for prosperity. We must restore conditions which will permit traditional American initiative and production genius to push on to ever higher standards of living and employment. Among these conditions, a fair tax system with minimum restraints on small and growing businesses is especially important.

## Next Important Step

I believe that this proposed tax revision is the next important step we should take in easing our tax burdens. After it is completed, further reductions in expenditures can be applied to our two objectives of balancing the budget and reducing tax rates.

A year ago I asked the secretary of the treasury to undertake a complete review of the tax system and make recommendations for changes. The committee on ways and means of the House of Representatives had already started constructive examination of the tax laws with the same objectives. Extensive hearings were held by the committee during the late spring and summer.

The proposed revision are the result of a year's intensive work. The collaboration between congressional and treasury staffs in the development of a tax revision bill has been very close. It may, I hope, provide a precedent for similar collaboration in other fields of legislation.

I shall not list here all the detailed points developed for the revision of the tax laws. The following recommendations cover the major points.

## Reduce Inequities

They will substantially reduce the more glaring inequities, thereby helping vast numbers of our people in their individual tax burdens. They will reduce the more serious restraints on production and economic growth. They will promote investment, which provides new and better methods of production and creates additional payrolls and more jobs.

The revisions will also make the law simpler and surer, with benefits to both taxpayers and the government. They will in many ways prevent abuses by which some taxpayers now avoid their rightful share of tax burdens by taking unfair advantage of technicalities.

**1. Children earning over 600 dollars.**—At present, parents cannot claim a dependent child who earns over 600 dollars a year. This discourages children in school or college from earning as much as they can to help in their support. I recommend that a parent should be permitted to continue to claim a child as a dependent regardless of the child's earnings if he is under 18 or away from home at school, as long as he is in fact still supported by the parent. Such dependents should, of course, continue to pay their own income tax on earnings above 600 dollars.

## Split Income Proposed

**2. Heads of families.**—At present, a widow or widower with dependent children is denied the full benefit of income-splitting available to married couples. It seems unfair to tax the income of a surviving parent with dependent children at higher rates than were applied to the family income before the death of one of the partners in a marriage. I recommend that widows and widowers with dependent children be allowed to split their income as is now done by married couples.

This same tax treatment should be authorized for single people supporting dependent parents. Furthermore, the present requirement that dependent parents must live with their children for the children to qualify for this tax treatment should be removed. It is often best for elderly people to be able to live in their own homes, and the tax laws should not put a penalty on family arrangements of this sort.

**3. Foster children as dependents.**—At present, foster children and children in process of adoption may not be claimed as dependents. I recommend that such children be allowed as dependents.

## Would Aid Child Care

**4. Expenses of child care.**—Some tax allowance can properly be given for actual costs of providing care for the small children of widows or widowers who have to work outside the home. The same tax privilege should be given to working mothers who, because their husbands are incapacitated, provide the principal support of their families.

**5. Medical expenses.**—The present tax allowances for unusual medical expenses are too limited to cover the many tragic emer-



PRESIDENT DWIGHT D. EISENHOWER

gencies which occur in too many families. I recommend that a tax allowance be given for medical expenses in excess of 3 per cent of income instead of 5 per cent as at present. I recommend further that the present ceiling of 1,250 dollars for a single person with a maximum ceiling of 5,000 dollars for a family should be doubled so that the maximum for a family will be 10,000 dollars. However, to avoid abuses in medical deductions, I recommend that the definition of medical expenses be tightened to exclude both ordinary household supplies and certain indirect travel expenses.

**6. Medical insurance and sick benefits for employees.**—Insurance and other plans adopted by employers to protect their employees against the risks of sickness should be encouraged by removing the present uncertainties in the tax law. It should be made clear that the employer's share of the costs of proving such protection on a group basis will not be treated as income on which the employer is liable for tax. This principal should be applied to medical and hospital insurance as well as to full or partial continuation of earnings during a sickness.

## Uncertainties Assailed

There should be no tax discrimination between plans insured with an outside insurance company and those financed directly by the employer. At present payments received by a person while sick are entirely nontaxable if made under an insured plan. This makes it possible for a person subject to high tax rates to have a much larger net income while on sick leave than while at work. To prevent abuses, I recommend that a limit of 100 dollars a week be placed on tax-free benefits, but this exemption should be extended only to plans meeting certain general standards.

**7. Pension and Profit-Sharing Plans for Employees.**—The conditions for qualification for special tax treatment of employers' pension plans are too involved. Such plans are desirable. I recommend that the rules be simplified and that greater discretion be given in establishing plans for different groups of employees, so long as there is no discrimination in favor of key executives or stockholders.

## Would Restrict Trusts

Under present law, the value of a future pension to a surviving widow or child of an employee is included in the husband's taxable estate, even though the survivors may not live to receive the full benefits and there may be no cash available to pay the tax. I recommend that such value should not be included in an estate but that the survivors continue to pay tax on the pension in the same manner that it was taxed to the person first receiving it.

At the same time, to avoid unfair competition with ordinary tax-paying businesses, I recommend that pension trusts be restricted in the same manner as tax-exempt foundations. They should also be subject to rules in regard to percentage distribution of their assets comparable to those applying to regulated investment companies.

**8. Taxation of Annuities.**—Under the present tax law, a person buying an annuity is taxed on a relatively large part of each payment until his cost is fully recovered, at which time the full amount becomes taxable. The tax rule is so strict that often a person is not likely to get his capital back tax free unless he lives beyond his life expectancy. I recommend that the tax treatment of annuities be determined on the basis of the life expectancy of the person receiving it. This will permit the hundreds of thousands of people who buy annuities to recover their capital free of tax over their life expect-

economic growth, increased production, and improved standards of living. It will help the manufacturer in buying new machinery and the storekeeper in expanding and modernizing his establishment. It will help the farmer get new equipment. All of this means many more jobs.

## Asks More Freedom

Specifically, I recommend that business be allowed more freedom in using straight-line depreciation and in selecting other methods of depreciation. Larger depreciation charges should be allowed in the early years of life of property by use of the declining-balance method of depreciation at rates double those permitted under the straight-line method. Other methods which give larger depreciation in early years should be accepted, so long as they do not produce deductions which exceed those available under the declining-balance method.

The new methods of depreciation should be allowed for investments in buildings, equipment and machinery made after January 1, 1954. This would include farm buildings and equipment and new construction of commercial and industrial buildings and rental housing.

Faster depreciation, it should be noted, will merely shift the tax deductions from later to earlier years. It will not increase total deductions. The change should, in fact, increase government revenues over the years because of the stimulation which it will give to enterprise and expansion.

## Double Taxation Hit

**9. Double Taxation of Dividends.**—At present, business income is taxed to both the corporation as it is earned and to the millions of stockholders as it is paid out of dividends. This double taxation is bad from two standpoints. It is unfair and it discourages investment. I recommend that a start be made in the removal of this double taxation by allowing stockholders a credit against their own income taxes as a partial offset for the corporate tax previously paid. This will promote investment which in turn means business expansion and more production and jobs.

Specifically, I recommend that the credit be allowed on an increasing scale over the next 3 years. For this year, I recommend that a credit of 5 per cent be allowed; for 1955, a credit of 10 per cent; and, in 1956 and later years, 15 per cent. To avoid shifts in the payment dates of corporation dividends, these credits should apply to dividends received after July 31 of each year. To give the full benefit immediately to small stockholders, I recommend that the first 50 dollars of dividends be completely exempted from tax in 1954 and that the first 100 dollars be exempted in 1955 and later years.

## Simple Penalty Asked

**10. Estimated Returns.**—The burden on those required to file estimated tax returns should be reduced by increasing the number of optional ways in which an individual can estimate his tax without being subject to penalty for an underestimate. I recommend also that the penalties resulting from underestimates be simplified by being stated as a 6-per cent interest charge on deficiencies.

**11. Filing Date.**—To reduce the burdens of preparing and filing returns in the early months of the year, I recommend that the March 15 filing date for individuals be changed to April 15.

In the taxation of business the same objective of fairness, simplicity, and reduction of tax barriers to production and normal economic growth are important. The present tax law should be revised on the basis of these standards.

Particular attention should be given in the revision of the law to the problems of small and growing business concerns. I cannot emphasize too strongly the social and economic importance of an environment which will encourage the formation, growth, and continued independent existence of new companies.

## Changes Advocated

**12. Depreciation.** A liberalization of the tax treatment of depreciation would have far-reaching effects on all business and is especially helpful in the expansion of small business whether conducted as individual proprietorships, partnerships, or corporations. At present, buildings, equipment, and machinery are usually written off uniformly over their estimated useful lives. The deductions allowed, especially in the early years, are often below the actual depreciation. This discourages long-range investment on which the risks cannot be clearly foreseen. It discourages the early replacement of old equipment with new and improved equipment. And it makes it more difficult to secure financing for capital investment, particularly for small business organizations.

I recommend that the tax treatment of depreciation be substantially changed to reduce these restrictions on new investment, which provides a basis for

the burden of proof that a retention of earnings is unreasonable.

**15. Taxation of Partnership.**—The tax law applicable to partnership is complex and uncertain. I recommend that it be simplified and made definite. It should be possible to form partnerships and make changes in them without undue tax complications.

## Option Proposed

**16. Optional tax treatment for certain corporations and partnership.**—Small businesses should be able to operate under whatever form of organization is desirable for their particular circumstances, without incurring unnecessary tax penalties. To secure this result, I recommend that corporations with a small number of active stockholders be given the option to be taxed as partnerships and that certain partnerships be given the option to be taxed as corporations.

**17. Corporate reorganizations.** The tax law applicable to reorganizations and recapitalizations of corporations is also complex and uncertain. This part of the law should be simplified and made sufficiently definite to permit people to know in advance the tax consequences of their actions.

The owners of small corporations frequently find it necessary to rearrange their interests in a corporation in anticipation of estate taxes, to secure new capital, or to make stock available for a new management group. I recommend that the tax law permit tax-free rearrangements of stockholders' interests in corporations, so long as no corporate earnings are withdrawn. Such changes will remove some of the tax pressures which force the sale of independent companies to larger corporations. At the same time, the law should be tightened to prevent abuses by which corporate earnings are withdrawn through the issuance and redemption of corporate securities. It should also be amended to avoid abuses through the purchase of corporations to acquire their rights to loss carryovers.

## Would Aid Research

**13. Research and development expenses.**—At present, companies are often not permitted to deduct currently for research or development expenses. This rule is especially burdensome to small concerns because large companies with established research laboratories can usually get immediate deductions. I recommend that all companies be given an option to capitalize or to write off currently their expenses arising from research and development work. Our tradition of initiative and rapid technical improvements must not be hampered by adverse tax rules.

**14. Accumulation of earnings.**—At present, the penalty tax on excessive accumulations of corporate earnings operates to discourage the growth of small companies which are peculiarly dependent on retained earnings for expansion. The tax in some form is necessary to prevent avoidance of individual taxes by stockholders, but I recommend that the law be changed to make the government assume

**18. Loss carryback.**—At present, losses may be carried back and offset against prior earnings for 1 year and carried forward to be offset against future earnings for 5 years. I recommend that the carryback be extended to 2 years. This will benefit established companies which become distressed. The 5-year carryforward should be continued to permit new businesses to offset their early losses against later profits.

**19. Soil conservation expenses.**—At present, only limited and uncertain tax deduction are allowed for soil conservation expenses on farms. I recommend that such deductions be allowed up to 25 per cent of the farmer's gross income.

**20. Accounting Definitions.**—Tax accounting should be brought

## Budget in Brief

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SPENDING	
1954:	\$70,902,000,000
1955:	\$65,570,000,000
Down	\$5,332,000,000
INCOME	
1954:	\$67,628,000,000
1955:	\$62,642,000,000
Down	\$4,986,000,000
DEFICIT	
1954:	\$3,274,000,000
1955:	\$2,928,000,000
Down	\$346,000,000
YEAR END DEBT	
1954:	\$269,750,000,000
1955:	\$273,000,000,000
Up	\$3,250,000,000

more nearly in line with accepted business accounting by allowing prepaid income to be taxed as it is earned rather than as it is received, and by allowing reserves to be established for known future expenses.

**21. Multiple surtax exemptions, consolidated returns, and intercorporate dividends.**—I recommend that the law be tightened to remove abuses from the use of multiple corporations in a single enterprise. I also recommend that the penalty tax on consolidated returns and intercorporate dividends be removed over a 3-year period.

## Modification Asked

**22. Business income from foreign sources.**—I recommend that the taxation of income from foreign business investments be modified in several respects. The investment climate and business environment abroad are much more important than our own tax laws in influencing the international flow of capital and business. Nonetheless, our capital and management know-how can be helpful in furthering economic development in other countries, and is desired by many of them. Our tax laws should contain no penalties against United States investment abroad and within reasonable limits should encourage private investment which should supplant government economic aid.

Specifically, I recommend the following new provisions in our taxation of business income from foreign sources:

(a) Business income from foreign subsidiaries or from segregated foreign branches which operate and elect to be taxed as subsidiaries should be taxed at a rate 14 percentage points lower than the regular corporate rate. This lower rate of tax should apply only to earnings after January 1, 1954.

(b) The present definition of foreign taxes which may be credited against the United States income tax should be broadened to include any tax other than an income tax which is the principal form of taxation on business in a country, except turnover, general sales or excise taxes, and social security taxes. This country, but its tax laws, should not bring in direct pressure on other countries

## Would Drop Limitation

(c) The overall limitation on foreign tax credits should be removed. This limitation discourages companies operating profitably in one foreign country from starting business in another foreign country where operations at a loss may be expected in the first few years.

(d) Regulated investment companies concentrating on foreign investments should be permitted to pass on to their stockholders the credit for foreign taxes which would be available on direct individual investments.

**23. Payment dates of corporation income tax.**—Over the past several years, corporation income tax payments have been gradually shifted forward into the first two of the regular quarterly dates. By 1955, the entire tax will be due in two equal installments in March and June.

The irregularity of tax receipts increases the problems in managing the public debt and is an unsettling influence in the money markets. The irregularity of tax payments also may make it harder for corporations to manage their own financing.

I recommend that, beginning in the Fall of 1955, a start be made in smoothing out corporate income tax payments by requiring advance payments in September and December before the end of the taxable year. Each of these payments should be made at 5 per cent of the amount due for the entire year in 1955, rising to 25 per cent each in 1959 and later years.

## Estimates Suggested

These advance payments will require estimates of income for the year somewhat comparable to those now required of individuals. Though estimates of profits are difficult to make accurately, no payments will be required before the middle of the ninth month of a business year.

**24. Administrative Provisions.**—The administrative features of the tax laws are unnecessarily complex. Different provisions have been adopted over the years to deal with particular problems, with little regard to consistency. Specifically, I recommend that the parts of the law covering assessments, collections, interest and penalties, the statute of limitations, and other administrative provisions be simplified and brought together in one place. This will result in savings to both taxpayers and the government.

An effective and fair administration of the tax laws is vital to every individual in the country. The Internal Revenue Service has been revitalized during the past year and being organized and managed on a basis that will assure fair and equal treatment to all taxpayers. . . .

## Regulations Tighter

The regulations and administration of the tax laws are being tightened to prevent abuses by which a small minority of taxpayers avoid their fair share of taxes by misuse of expense accounts and other improper practices.

## General Simplification of Tax Laws and Other Revisions

The revision of the tax laws should be comprehensive. Many unnecessary complications have developed over the years. The entire internal revenue code needs rewriting and reorganization.

Jointly, the treasury department and the staff of the congressional committees have developed many recommendations for changes other than those which I have described here. Some of these relate to the estate and gift tax, and the administrative provisions of the excise taxes.

The review of the present tax system in the treasury department has not yet led to final conclusions in many other situations that require further study before any recommendations for change can be properly made. These subjects include the tax treatment of capital gains and losses, the special problems of the oil and mining industries, the tax treatment of cooperatives and organizations which are wholly or partially tax exempt, as well as the provision of retirement income for people not covered by pension plans.

## Fairer System Sought

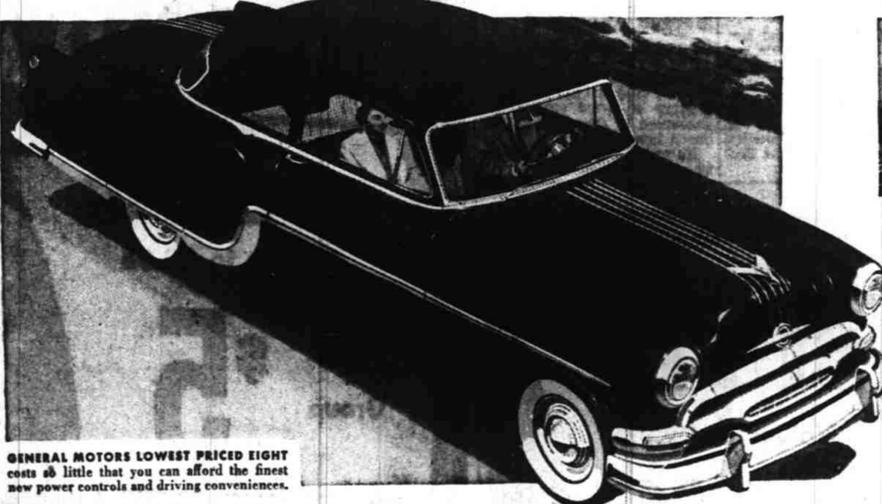
The tax reforms and revisions covered by the foregoing 25 recommendations make the income tax system fairer to individuals and less burdensome on production and continued economic growth. After their adoption, further reductions in government expenditures will make possible additional reductions in the deficit and tax rates.

I do not believe that the budgetary situation justifies any tax reductions beyond those involved in the proposed tax revision and in the tax changes which occurred on January 1. Accordingly, I repeat my recommendation of last May that the reduction in the general corporate income tax rate be deferred for another year.

Excise taxes provide a relatively small proportion of our total tax revenues. In the fiscal year 1955, they are estimated to produce 10 billion dollars at existing rates as compared with 20 billion dollars from corporation income taxation and 30 billion dollars from individual income taxes. Of this 10 billion dollars, more than half comes from the excise taxes on liquor, tobacco and gasoline.

Because of the present need for revenue, I recommend that the excise taxes scheduled to be reduced on April 1, including those on liquor, tobacco, automobiles, and gasoline, be continued at present rates; and that any adjustments in the other excise taxes be such as to maintain the total yield which we are now receiving from this source.

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