John Fitzgerald Kennedy (1917-1963)

Special Message to the Congress on Taxation

given on April 20, 1961

To the Congress of the United States:

A strong and sound Federal tax system is essential to America's future. Without such a system, we cannot maintain our defenses and give leadership to the free world. Without such a system, we cannot render the public services necessary for enriching the lives of our people and furthering the growth of our economy.

The tax system must be adequate to meet our public needs. It must meet them fairly, calling on each of us to contribute his proper share to the cost of government. It must encourage efficient use of our resources. It must promote economic stability and stimulate economic growth. Economic expansion in turn creates a growing tax base, thus increasing revenue and thereby enabling us to meet more readily our public needs, as well as our needs as private individuals.

This message recognizes the basic soundness of our tax structure. But it also recognizes the changing needs and standards of our economic and international position, and the constructive reform needs to keep our tax system up to date and to maintain its equity. Previous messages have emphasized the need for prompt Congressional and Executive action to alleviate the deficit in our international balance of payments--to increase the modernization, productivity and competitive status of American industry--to stimulate the expansion and growth of our economy--to eliminate to the extent possible economic injustice within our own society--and to maintain the level of revenues requested in my predecessor's Budget. In each of these endeavors, tax policy has an important role to play and necessary tax changes are herein proposed.

The elimination of certain defects and inequities as proposed below will provide revenue gains to offset the tax reductions offered to stimulate the economy. Thus no net loss of revenue is involved in this set of proposals. I wish to emphasize here that they are a "set"--and that considerations of both revenue and equity, as well as the interrelationship of many of the proposals, urge their consideration as a unit.

I am instructing the Secretary of the Treasury to furnish the Committee on Ways and Means of the House a detailed explanation of these proposals in connection with their legislative consideration.

I. LONG-RANGE TAX REFORM

While it is essential that the Congress receive at this time this Administration's proposals for urgent and obvious tax adjustments needed to fulfill the aims listed above, time has not permitted the comprehensive review necessary for a tax structure which is so complicated and so critically important to so many people. This message is but a first though urgent step along the road to constructive reform.

I am directing the Secretary of the Treasury, building on recent tax studies of the Congress, to undertake the research and preparation of a comprehensive tax reform program to be placed before the next session of the Congress.

Progressing from these studies, particularly those of the Committee on Ways and Means and the Joint Economic Committee, the program should be aimed at providing a broader and more uniform tax base, together with an appropriate rate structure. We can thereby work toward the goal of a higher rate of economic growth, a more equitable tax structure, and a simpler tax law. I know these objectives are shared by--and, at this particular time of year, acutely desired by--the vast majority of the American people.

In meeting the demands of war finance, the individual income tax moved from a selective tax imposed on the wealthy to the means by which the great majority of our citizens participates in paying for well over one-half of our total budget receipts. It is supplemented by the corporation income tax, which provides for another quarter of the total.

This emphasis on income taxation has been a sound development. But so many taxpayers have become so preoccupied with so many tax-saving devices that business decisions are interfered with, and the efficient functioning of the price system is distorted.

Moreover, special provisions have developed into an increasing source of preferential treatment to various groups. Whenever one taxpayer is permitted to pay less, someone else must be asked to pay more. The uniform distribution of

the tax burden is thereby disturbed and higher rates are made necessary by the narrowing of the tax base. Of course, some departures from uniformity are needed to promote desirable social or economic objectives of overriding importance which can be achieved most effectively through the tax mechanism. But many of the preferences which have developed do not meet such a test and need to be reevaluated in our tax reform program.

It will be a major aim of our tax reform program to reverse this process, by broadening the tax base and reconsidering the rate structure. The result should be a tax system that is more equitable, more efficient and more conducive to economic growth.

II. TAX INCENTIVE FOR MODERNIZATION AND EXPANSION

The history of our economy has been one of rising productivity, based on improvement in skills, advances in technology, and a growing supply of more efficient tools and equipment. This rise has been reflected in rising wages and standards of living for our workers, as well as a healthy rate of growth for the economy as a whole. It has also been the foundation of our leadership in world markets, even as we enjoyed the highest wage rates in the world.

Today, as we face serious pressure on our balance of payments position, we must give special attention to the modernization of our plant and equipment. Forced to reconstruct after wartime devastation, our friends abroad now possess a modern industrial system helping to make them formidable competitors in world markets. If our own goods are to compete with foreign goods in price and quality, both at home and abroad, we shall need the most efficient plant and equipment.

At the same time, to meet the needs of a growing population and labor force, and to achieve a rising per capita income and employment level, we need a high and rising level of both private and public capital formation. In my preceding messages, I have proposed programs to meet some of our needs for such capital formation in the public area, including investment in intangible capital such as education and research, as well as investment in physical capital such as buildings and highways. I am now proposing additional incentives for the modernization and expansion of private plant and equipment.

Inevitably, capital expansion and modernization-now frequently under the name of automation--alter established modes of production. Great benefits result and are distributed widely--but some hardships result as well. This places heavy responsibilities on public policy, not to retard modernization and capital expansion but to promote growth and ameliorate hardships when they do occur--to maintain a high level of demand and employment, so that those who are displaced will be reabsorbed quickly into new positions--and to assist in retraining and finding new jobs for such displaced workers. We are developing, through such measures as the Area Redevelopment Bill and a strengthened Employment Service, as well as assistance to the unemployed, the programs designed to achieve these objectives.

High capital formation can be sustained only by a high and rising level of demand for goods and service. Indeed, the investment incentive itself can contribute materially to achieving the prosperous economy under which this incentive will make its maximum contribution to economic growth. Rather than delaying its adoption until all excess capacity has disappeared and unemployment is low, we should take this step now to strengthen our anti-recession program, stimulate employment and increase our export markets.

Additional expenditures on plant and equipment will immediately create more jobs in the construction, lumber, steel, cement, machinery and other related capital goods industries. The staffing of these new plants--and filling the orders for new export markets--will require additional employees. The additional wages of these workers will help create still more jobs in consumer goods and service industries. The increase in jobs resulting from a full year's operation of such an incentive is estimated at about half a million.

Specifically, therefore, I recommend enactment of an investment tax incentive in the form of a tax credit of

--15% of all new plant and equipment investment expenditures in excess of current depreciation allowances

--6% of such expenditures below this level but in excess of 50% of depreciation allowances; with

--10% on the first $5,000 of new investment as a minimum credit.

This credit would be taken as an offset against the firm's tax liability, up to an overall limitation of 30% in the reduction of that liability in any one year. It would be separate from and in addition to depreciation of the eligible new investment at cost. It would be available to individually owned businesses as well as corporate enterprises, and apply

to eligible investment expenditures made after January 1 of this year. To remain a real incentive and make a maximum contribution to those areas of capital expansion and modernization where it is most needed, and to permit efficient administration, eligible investment expenditures would be limited to expenditures on new plant and equipment, on assets located in .the United States, and on assets with a life of six years or more. Investments by public utilities other than transportation would be excluded, as would be investment in residential construction including apartments and hotels.

Of the eligible firms, it is expected that many small firms would be able to take advantage of the minimum credit of 10% on the first $5000 of new investment which is designed to provide a helpful stimulus to the many small businesses in need of modernization. Other small firms, subject to a 30% tax rate, would strive to be eligible for the full 15% credit--the equivalent for such firms of a deduction from their gross income for tax purposes of 50% of the cost of new investment. Among the remaining firms, it is expected that a majority would be induced to make new investments in modern plant and equipment in excess of their depreciation in order to earn the 15% credit. New and growing firms would be particularly benefited. The 6% credit for those whose new investment expenditures fall between 50% and 100% of their depreciation allowances is designed to afford some substantial incentive to the depressed or hesitant firm which knows it cannot yet achieve the 15% credit.

In arriving at this form of tax encouragement to investment, careful consideration was given to other alternatives. If the credit were given across-the-board to all new investment, a much larger revenue loss would result from those expenditures which would have been undertaken anyway or represent no new level of effort. Our objective is to provide the largest possible inducement to new investment which would not otherwise be undertaken. Thus the plan recommended above would involve the same revenue loss--approximately $1.7 billion--as only a 7 percent credit across-the-board to all new investment.

The use of current depreciation allowances as the threshold above which the higher rate of credit would apply recommends itself for a number of reasons. Depreciation reflects the average level of investment over the past, but is a less restrictive and more stable test than the use of an average of investment expenditures for a period such as the preceding five years. In addition, the depreciation allowances themselves in effect supply tax-free funds for investment up to this level. We now propose a tax credit-which would help to secure funds needed for the additional investment beyond that level.

The proposed credit, in terms of the revenue loss involved, will also be much more effective as an inducement to investment than an outright reduction in the rate of corporation income tax. Its benefits would be distributed more broadly, since the proposed credit will apply to individuals and partnerships as well as corporations. It will also be more effective as a direct incentive to corporate investment, and increase available funds more specifically in those corporations most likely to use them for additional investment. In short, whereas the credit will have the advantage of focusing on the profitability of new investment, much of the revenue loss under a general corporate rate reduction would be diverted into raising the profitability of old investment.

It is true that this advantage of focusing entirely on new investment is shared by the alternative strongly urged by some--a tax change permitting more rapid depreciation of new assets (be it accelerated depreciation or an additional depreciation allowance for the first year). But the proposed investment credit would be superior, in my view, for a number of reasons. In the first place, the determination of the length of an asset's life and proper methods of depreciation have a normal and important function in determining taxable income, wholly apart from any considerations of incentive; and they should not be altered or manipulated for other purposes that would interfere with this function. It may be that on examination some of the existing depreciation rules will be found to be outmoded and inequitable; but that is a question that should be separated from investment incentives. A review of these rules and methods is underway in the Treasury Department as a part of its overall tax reform study to determine whether changes are appropriate and, if so, what form they should take. Adoption of the proposed incentive credit would in no way foreclose later action on these aspects of depreciation.

In the second place, an increase in tax depreciation tends to be recorded in the firm's accounts, thereby raising current costs and acting as a deterrent to price reduction. The proposed investment credit would not share this defect.

Finally, it is clear that the tax credit would be more effective in inducing new investment for the same revenue loss. The entire credit would be reflected immediately in the increased funds available for investment without increasing the company's future tax liability. A speed-up in depreciation only postpones the timing of the tax liability on profits from the investment to a later date--an increase in profitability not comparable to that of an outright tax credit. Yet accelerated depreciation is much more costly in immediate revenues.

For example, on an average investment, a tax credit of 15% would bring the same return to the firm as an additional first year depreciation of over 50% of the cost of the investment. Yet the immediate revenue loss to the Treasury from such additional depreciation would be twice as much, and would remain considerably higher for many years. The incentive to new investment our economy needs, and which this recommendation would provide at a revenue loss of $ 1.7 billion, could be supplied by an initial write-off only at an immediate cost of $3.4 billion.

I believe this investment tax credit will become a useful and continuous part of our tax structure. But it will be a new venture and remain in need of review. Moreover, it may prove desirable for the Congress to modify the credit from time to time, so as to adapt it to the needs of a changing economy. I strongly urge its adoption in this session.

III. TAX TREATMENT OF FOREIGN INCOME

Changing economic conditions at home and abroad, the desire to achieve greater equity in taxation, and the strains which have developed in our balance of payments position in the last few years, compel us to examine critically certain features of our tax system which, in conjunction with the tax system of other countries, consistently favor United States private investment abroad compared with investment in our own economy.

1. Elimination of tax deferral privileges in developed countries and "tax haven" deferral privileges in all countries. Profits earned abroad by American firms operating through foreign subsidiaries are, under present tax laws, subject to United States tax only when they are returned to the parent company in the form of dividends. In some cases, this tax deferral has made possible indefinite postponement of the United States tax; and, in those countries where income taxes are lower than in the United States, the ability to defer the payment of U.S. tax by retaining income in the subsidiary companies provides a tax advantage for companies operating through overseas subsidiaries that is not available to companies operating solely in the United States. Many American investors properly made use of this deferral in the conduct of their foreign investment. Though changing conditions now make continuance of the privilege undesirable, such change of policy implies no criticism of the investors who so utilize this privilege.

The undesirability of continuing deferral is underscored where deferral has served as a shelter for tax escape through the unjustifiable use of tax havens such as Switzerland. Recently more and more enterprises organized abroad by American firms have arranged their corporate structures--aided by artificial arrangements between parent and subsidiary regarding intercompany pricing, the transfer of patent licensing rights, the shifting of management fees, and similar practices which maximize the accumulation of profits in the tax haven--so as to exploit the multiplicity of foreign tax systems and international agreements in order to reduce sharply or eliminate completely their tax liabilities both at home and abroad.

To the extent that these tax havens and other tax deferral privileges result in U.S. firms investing or locating abroad largely for tax reasons, the efficient allocation of international resources is upset, the initial drain on our already adverse balance of payments is never fully compensated, and profits are retained and reinvested abroad which would otherwise be invested in the United States. Certainly since the postwar reconstruction of Europe and Japan has been completed, there are no longer foreign policy reasons for providing tax incentives for foreign investment in the economically advanced countries.

If we are seeking to curb tax havens, if we recognize that the stimulus of tax deferral is no longer needed for investment in the developed countries, and if we are to emphasize investment in this country in order to stimulate our economy and our plant modernization, as well as ease our balance of payments deficit, we can no longer afford existing tax treatment of foreign income.

I therefore recommend that legislation be adopted which would, after a two-step transitional period, tax each year American corporations on their current share of the undistributed profits realized in that year by subsidiary corporations organized in economically advanced countries. This current taxation would also apply to individual shareholders of closely-held corporations in those countries. Since income taxes paid abroad are properly a credit against the United States income tax, this would subject the income from such business activities to essentially the same tax rates as business activities conducted in the United States. To permit firms to adjust their operations to this change, I also recommend that this result be achieved in equal steps over a two-year period, under which only one-half of the profits would be affected during 1962. Where the foreign taxes paid have been close to the U.S. rates, the impact of this change would be small.

This proposal will maintain United States investment in the developed countries at the level justified by market forces. American enterprise abroad will continue to compete with foreign firms. With their access to capital markets at home and abroad, their advanced technical know-how, their energy, resourcefulness and many other advantages, American

firms will continue to occupy their rightful place in the markets of the world. While the rate of expansion of some American business operations abroad may be reduced through the withdrawal of tax deferral such reduction would be consistent with the efficient distribution of capital resources in the world, our balance of payments needs, and fairness to competing firms located in our own country.

At the same time, I recommend that tax deferral be continued for income from investment in the developing economies. The free world has a strong obligation to assist in the development of these economies, and private investment has an important contribution to make. Continued income tax deferral for these areas will be helpful in this respect. In addition, the proposed elimination of income tax deferral on United States earnings in industrialized countries should enhance the relative attraction of investment in the less developed countries.

On the other hand, I recommend elimination of the "tax haven" device anywhere in the world, even in the underdeveloped countries, through the elimination of tax deferral privileges for those forms of activities, such as trading, licensing, insurance and others, that typically seek out tax haven methods of operation. There is no valid reason to permit their remaining untaxed regardless of the country in which they are located.

2. Taxation of Foreign Investment Companies. For some years now we have witnessed substantial outflows of capital from the United States into investment companies created abroad whose principal justification lies in the tax benefits which their method of operation produces. I recommend that these tax benefits be removed and that income derived through such foreign investment companies be treated in substantially the same way as income from domestic investment companies.

3. Taxation of American Citizens Abroad. It is no more justifiable to provide tax exemptions for individuals living in the developed countries than it is to provide tax inducements for capital investment there. Nor should we permit totally unjustified tax benefits to be obtained by those Americans whose choice of residence is dictated primarily by their desire to minimize taxes.

I, therefore, recommend:

--that the total tax exemption now accorded the earned income of American citizens residing abroad be completely terminated for those residing in economically advanced countries;

--that this exemption for earned income be limited to $20,000 for those residing in the less developed countries; and

--that the exemption of $20,000 of earned income now accorded those citizens who stay (but do not reside) abroad for 17 out of 18 months also be completely terminated for those living or traveling in the economically advanced countries.

4. Estate Tax on Property Located Abroad. I recommend that the exclusion from the estate tax accorded real property situated abroad be terminated. With the adoption several years ago of the credit for foreign taxes under the estate tax, there is no justification for the continued exemption of such property.

5. Allowance for Foreign Tax on Dividends. Finally, the method by which the credit for foreign income taxes is computed in the case of dividends involves a double allowance for foreign income taxes and should be corrected.

These proposals, along with more detailed and technical changes needed to improve the taxation of foreign income, are expected to reduce substantially our balance of payments deficit and to increase revenues by at least $250 million per year.

IV. CORRECTION OF OTHER STRUCTURAL DEFECTS

I next recommend a number of measures to remove other serious defects in the income tax structure. These changes, while making a beginning toward the comprehensive tax reform program mentioned above, will provide sufficient revenue gains to offset the cost of the investment tax credit and keep the revenue-producing potential of our tax structure intact.

1. Withholding on Interest and Dividends. Our system of combined withholding and voluntary reporting on wages and salaries under the individual income tax has served us well. Introduced during the war when the income tax was extended to millions of new taxpayers, the wage-withholding system has been one of the most important and successful advances in our tax system in recent times. Initial difficulties were quickly overcome, and the new system helped the taxpayer no less than the tax collector.

It is the more unfortunate, therefore, that the application of the withholding principle has remained incomplete. Withholding does not apply to dividends and interest, with the result that substantial amounts of such income, particularly interest, improperly escape taxation. It is estimated that about $3 billion of taxable interest and dividends are unreported each year. This is patently unfair to those who must as a result bear a larger share of the tax burden. Re-cipients of dividends and interest should pay their tax no less than those who receive wage and salary income, and the tax should be paid just as promptly. Large continued avoidance of tax on the part of some has a steadily demoralizing effect on the compliance of others.

This gap in reporting has not been appreciably lessened by educational programs. Nor can it be effectively closed by intensified enforcement measures, except by the expenditure of inordinate amounts of time and money. Withholding on corporate dividends and on investment type interest, such as interest paid on taxable government and corporate securities and savings accounts, is both necessary and practicable.

I, therefore, recommend the enactment of legislation to provide for a 20% withholding rate on corporate dividends and taxable investment type interest, effective January 1, 1962, under a system which would not require the preparation of withholding statements to be sent to recipients. It would thus place a relatively light burden of compliance on the payers of interest and dividends--certainly less than that placed on payers of wages and salaries--while at the same time largely solving the compliance problem for most of the taxpayers receiving dividends and interest. Steps will also be taken to avoid hardships for recipients who are not subject to tax.

The remaining need for compliance, largely in the high income group subject to a higher tax rate, would be met through the concentration of enforcement devices on taxpayers in these brackets. Introduction of equipment for the automatic processing of information returns would be especially helpful for this purpose and would thus supplement the extension of withholding.

Enactment of this proposal is estimated to increase revenue by $600 million per year.

2. Repeal of the Dividend Credit and Exclusion. The present law provides for an exclusion from income of the first $50 of dividends received from domestic corporations and for a 4% credit against tax of such dividend income in excess of $50. These provisions were enacted in 1954. Proponents argued that they would encourage capital formation through equity investment, and that they would provide a partial offset to the so-called double taxation of dividend income. It is now clear that they serve neither purpose well; and I, therefore, recommend the repeal of both the dividend credit and exclusion.

The dividend credit and exclusion are not an efficient stimulus to capital expansion in the form of plant and equipment. The revenue losses resulting from these provisions are spread over a large volume of outstanding shares rather than being concentrated on new shares; and the stimulating effects of the provisions are thus greatly diluted, resulting in relatively little increases in the supply of equity funds and a relatively slight reduction in the cost of equity financing. In fact, such reduction as does occur is more likely to benefit large corporations with easy access to the capital market, while being of little use to small firms which are not so favorably situated. Insofar as raising the profitability of new investment in plant and equipment is concerned, the tax investment credit proposed above would be far more effective since it is offered to the corporation, where the actual investment decision is made.

The dividend credit and exclusion are equally inadequate as a solution to the so-called problem of double taxation. Whatever may be the merits of the arguments respecting the existence of double taxation, the provisions of the 1954 Act clearly do not offer an appropriate remedy. They greatly overcompensate the dividend recipient in the high income bracket, while giving either insufficient or no relief to shareholders with smaller income.

This point deserves emphasis. For viewed simply as a means of tax reduction, the dividend credit is. wholly inequitable. The distribution of its benefits is highly favorable to the taxpayers in the upper income groups who receive the major part of dividend income. Only about 10 percent of dividend income accrues to those with incomes below $5,000; about 80 percent of it accrues to that 6.5% of taxpayers whose incomes exceed $10,000 a year. Similarly, dividend income is a sharply rising fraction of total income as we move up the income scale. Thus, dividend income is about 1 percent of all income from all sources for those taxpayers with incomes of $3,000 to $5,000; but it constitutes more than 25 percent of the income for those with $100,000 to $150,000 of income, and about 50 percent for those with incomes over $1,000,000,

The role of the dividend credit should not be confused with the broader question of tax rates applicable to high incomes. These high rates deserve re-examination; and this is one of the problems which will be examined in the context of next year's tax reform. But if top bracket rates were to be reduced, the dividend credit is not the way to do

it. Rate reductions, if appropriate, should apply no less to those with high incomes from other sources, such as professional and salaried people whose tax position is particularly difficult today.

If the credit is eliminated, the $50 exclusion should also be discarded for similar reasons. The tax saving from the exclusion is substantially greater for a dividend recipient with a high income than for a recipient with low income. Moreover, on equity grounds, there is no reason for giving tax reduction to that small fraction of low income tax payers who receive dividends in contrast to those who must live on wages, interest, rents or other forms of income.

The 1954 formula therefore is a dead-end and should be rescinded, effective December 31 of this year. The estimated revenue gain is $450 million per year.

3. Expense Accounts. In recent years widespread abuses have developed through the use of the expense account. Too many firms and individuals have devised means of deducting too many personal living expenses as business expenses, thereby charging a large part of their cost to the Federal Government. Indeed, expense account living has become a byword in the American scene.

This is a matter of national concern, affecting not only our public revenues, our sense of fairness, and our respect for the tax system, but our moral and business practices as well. This widespread distortion of our business and social structure is largely a creature of the tax system, and the time has come when our tax laws should cease their encouragement of luxury spending as a charge on the Federal treasury. The slogan--"It's deductible"--should pass from our scene.

Tighter enforcement of present legislation will not suffice. Even though in some instances entertainment and related expenses have an association with the needs of business, they nevertheless confer substantial tax-free personal benefits to the recipients. In other cases, deductions are obtained by disguising personal expenses as business outlays. But under present law, it is extremely difficult to separate out and disallow such pseudo-business expenditures. New legislation is needed to deal with the problem.

I, therefore, recommend that the cost of such business entertainment and the maintenance of entertainment facilities (such as yachts and hunting lodges) be disallowed in full as a tax deduction and that restrictions be imposed on the deductibility of business gifts, expenses of business trips combined with vacations, and excessive personal living expenses incurred on business travel away from home.

I feel confident that these measures will be welcomed by the American people. I am also confident that business firms, now forced to emulate the expense account favors of their competitors, however unsound or uneconomical such practices may be, will welcome the removal of this pressure. These measures will strengthen both our tax structure and the moral fibre of our society. These provisions should be effective as of January 1, 1962 and are estimated to increase Treasury receipts by at least $250 million per year.

4. Capital Gains on Sale of Depreciable Business Property. Another flaw which should be corrected at this time relates to the taxation of gains on the sale of depreciable business property. Such gains are now taxed at the preferential rate applicable to capital gains, even though they represent ordinary income.

This situation arises because the statutory rate of depreciation may not coincide with the actual decline in the value of the asset. While the taxpayer holds the property, depreciation is taken as a deduction from ordinary income. Upon its resale, where the amount of depreciation allowable exceeds the decline in the actual value of the asset so that a gain occurs, this gain under present law is taxed at the preferential capital gains rate. The advantages resulting from this practice have been increased by the liberalization of depreciation rates.

Our capital gains concept should not encompass this kind of income. This inequity should be eliminated, and especially so in view of the proposed investment credit. We should not encourage through tax incentives the further acquisition of such property as long as this loophole remains.

I therefore recommend that capital gains treatment be withdrawn from gains on the disposition of depreciable property, both personal and real property, to the extent that depreciation has been deducted for such property by the seller in previous years, permitting only the excess of the sales price over the original cost to be treated as a capital gain. The remainder should be treated as ordinary income. This reform should immediately become effective as to all sales taking place after the date of enactment. It is estimated to raise revenue by $200 million annually.

5. Cooperatives and Financial Institutions. Another area of the tax laws which calls for attention is the treatment of

cooperatives, private lending institutions, and fire and casualty insurance companies.

Contrary to the intention of Congress, substantial income from certain cooperative enterprises, reflecting business operations, is not being taxed either to the cooperative organization itself or its members. This situation must be corrected in a manner that is fair and just to both the cooperatives and competing businesses.

The present inequity has resulted from court decisions which held patronage refunds in certain forms to be non-taxable. I recommend that the law be clarified so that all earnings are taxable to either the cooperatives or to their patrons, assessing the patron on the earnings that are allocated to him as patronage dividends or refunds in scrip or cash. The withholding principle recommended above should also be applied to patronage dividends or refunds so that the average patron receiving scrip will, in effect, be given the cash to pay his tax on his patronage dividend or refund. The cooperatives should not be penalized by the assessment of a patronage tax upon dividends or refunds taxable to the patron but left in the business as a substitute for the sale of securities to obtain additional equity capital. The exemption for rural electric cooperatives and credit unions should be continued.

The tax provisions applicable to fire and casualty insurance companies, originally adopted in 1942, need to be reviewed in the light of current conditions. Many of these companies, organized on the mutual or reciprocal basis are now taxed under a special formula which does not take account of their underwritings gains and thus results in an inequitable distribution of the tax burden among various types of companies. Consideration should be given to taxing mutual or reciprocal companies on a basis similar to stock companies, following the pattern of similar treatment of stock and mutual enterprise in the life insurance field.

Some of the most important types of private savings and lending institutions in the country are accorded tax deductible reserve provisions which substantially reduce or eliminate their Federal income tax liability. These provisions should be reviewed with the aim of assuring non-discriminatory treatment.

Remedial legislation in these fields would enlarge the revenues and contribute to a fair and sound tax structure.

V. TAX ADMINISTRATION

One of the major characteristics of our tax system, and one in which we can take a great deal of pride, is that it operates primarily through individual self-assessment. The integrity of such a system depends upon the continued willingness of the people honestly and accurately to discharge this annual price of citizenship. To the extent that some people are dishonest or careless in their dealings with the government, the majority is forced to carry a heavier tax burden.

For voluntary self-assessment to be both meaningful and productive of revenues, the citizens must not only have confidence in the fairness of the tax laws, but also in their uniform and vigorous enforcement of these laws. If non-compliance by the few continues unchecked, the confidence of the many in our self-assessment system will be shaken and one of the cornerstones of our government weakened.

I have in this message already recommended the application of withholding to dividends and interest and revisions to halt the abuses of expense accounts. These measures will improve taxpayer compliance and raise the regard of taxpayers for the fairness of our system. In addition, I propose three further measures to improve the tax enforcement machinery.

1. Taxpayer Account Numbers. The Internal Revenue Service has begun the installation of automatic data processing equipment to improve administration of the growing job of tax collection and enforcement. A system of identifying taxpayer account numbers, which would make possible the bringing together of all tax data for any one particular taxpayer, is an essential part of such an improved collection and enforcement program.

For this purpose, social security numbers would be used by taxpayers already having them. The small minority currently without such numbers' would be assigned numbers which these persons could later use as well for social security purposes if needed. The numbers would be entered on tax returns, information returns, and related documents.

I recommend that legislation be enacted to authorize the use of taxpayer account numbers beginning January 1, 1962 to identify taxpayer accounts throughout the processing and record keeping operations of the Internal Revenue Service.

2. Increased Audit Coverage. The examination of tax returns is the essence of the enforcement process. The number of examining personnel of the Internal Revenue Service, however, has been consistently inadequate to cope with the audit workload. Consequently, it has been unable to audit carefully many of the returns which should be so examined. Anticipated growth in our population will, of course, increase this enforcement problem.

Related to broadened tax audit is the criminal enforcement program of the Revenue Service. Here, the guiding principle is the creation of a deterrent to tax evasion and to maintain or, if possible, increase voluntary compliance with all taxing statutes. This means placing an appropriate degree of investigative emphasis on all types of tax violations, in all geographical areas, and identifying violations of substance in all income brackets regardless of occupation, business or profession.

Within this framework of a balanced enforcement effort, the Service is placing special investigative emphasis on returns filed by persons receiving income from illegal sources. I have directed all Federal law enforcement agencies to cooperate fully with the Attorney General in a drive against organized crime, and to utilize their resources to the maximum extent in conducting investigations of individuals engaged in criminal activity on a major scale. With the foregoing in mind, I have directed the Secretary of the Treasury to provide through the Internal Revenue Service a maximum effort in this field.

To fulfill these requirements for improved audits, enforcement and anti-crime investigation, it is essential that the Service be provided additional resources which will pay their own cost many times over. In furthering the Service's long-range plans, the prior Administration asked additional appropriations of $27.4 million to hire about 3,500 additional personnel during fiscal 1962, including provisions for the necessary increases in space and modern equipment vital to the efficient operation of the Service. To meet the commitments described above, this Administration reviewed these proposals and recommended that they be increased by another $7 million and 765 additional personnel to expedite the expansion and criminal enforcement programs. The pending alternative of only 1,995 additional personnel, or less than one-half of the number requested, this Administration would constitute little more than the additional employees needed each year during the 1960's just to keep up with the estimated growth in number and complexity of returns filed. Thus I must again strongly urge the Congress to give its full support to my original request. These increases will safeguard the long-term adequacy of the nation's traditional voluntary compliance system and, at the same time, return the added appropriations several times over in added revenue.

3. Inventory Reporting. It is increasingly apparent that the manipulation of inventories has become a frequent method of avoiding taxes. Current laws and regulations generally permit the use of inventory methods which are acceptable in recognized accounting practice. Deviations from these methods, which are not always easy to detect during examination of tax returns, can often lead to complete non-payment of taxes until the inventories are liquidated; and, for some taxpayers, this represents permanent tax reduction. The understating of the valuation of inventories is the device most fiequently used.

I have directed the Internal Revenue Service to give increasing attention to this area of tax avoidance, through a stepped-up emphasis on both the verification of the amounts reported as inventories and an examination of methods used in arriving at their reported valuation.

VI. TAX RATE EXTENSION

As recommended by my predecessor, it is again necessary that Congress enact an extension of present corporation income and excise tax rates otherwise scheduled for reduction or termination on July 1, 1961 Such extension has been adopted by the Congress on a number of previous occasions, and our present revenue requirements make such extension absolutely necessary again this year.

In the absence of such legislation, the corporate tax rate would be decreased 5 percentage points, from 52 percent to 47 percent, excise tax rates on distilled spirits, beer, wines, cigarettes, passenger automobiles, automobile parts and accessories, and the transportation of persons would also decline; and the excise tax on general telephone service would expire. We cannot afford the loss of these revenues at this time.

VII. AVIATION FUEL

The last item on the agenda relates to aviation fuel. The two previous Administrations have urged that civil aviation, a mature and growing industry, be required to pay a fair share of the costs of operating and improving the Federal airways system. The rapidly mounting costs of these essential services to air transportation makes the imposition of user charges more imperative now than ever before. The most efficient method for recovering a portion of these costs

equitably from the airway users is through a tax on aviation fuel. Present law provides for a net tax of 2 cents a gallon on aviation gasoline but no tax on jet fuel. The freedom from tax of jet fuel is inequitable and is resulting in substantial revenue losses due to the transition to jet power and the resulting decline in gasoline consumption.

My predecessor recommended a flat 41/2 cent tax for both aviation gasoline and jet fuels. Such a request, however, appears to be unrealistic in view of the current financial condition of the airline industry. Therefore, I recommend:

--extending the present net 2-cent rate on aviation gasoline to jet fuels;

--holding this uniform rate covering both types of fuel at the 2-cent level for fiscal 1962; and

--providing for annual increments in this rate of 1/2 cent after fiscal year 1962 until the portion of the cost of the airways properly allocable to civil aviation is substantially recovered by this tax.

The immediate increase in revenue from this proposal is modest in comparison with anticipated airways costs; and the annual gradation of further increases is intended to moderate the impact of the tax on the air carrier industry. Should future economic or other developments warrant, a more rapid increase in the fuel tax will be recommended. The decline from the revenues estimated by my predecessor is not large, and will be met by the reforms previously proposed. I repeat my earlier recommendation that, consistent with the user charge principle, revenues from the aviation fuels tax be retained in the general fund rather than diverted to the highway trust fund.

CONCLUSION

The legislation recommended in this message offers a first step toward the broader objective of tax reform. The immediate need is for encouraging economic growth through modernization and capital expansion, and to remove tax preferences for foreign investment which are no longer needed and which impair our balance of payments position. A beginning is made also toward removing some of the more glaring defects in the tax structure. The revenue gain in these proposals will offset the revenue cost of the investment credit. Finally, certain rate extensions are needed to maintain the revenue potential of our fiscal system.

These items need to be done now; but they are a first step only. They will be followed next year by a second set of proposals, aimed at thorough income tax reform. Their purpose will be to broaden and unify the income tax base, and to review the entire rate structure in the light of these revisions. Let us join in solving these immediate problems in the coming months, and then join in further action to strengthen the foundations of our revenue system.

JOHN F. KENNEDY
(7525 words)

Quelle: http://www.presidency.ucsb.edu/ws/index.php?pid=8074&st=&st1=