

C. Douglas Dillon Oral History Interview – JFK#6, 09/21/1964
Administrative Information

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Biographical Note

Dillon, Secretary of the Treasury (1961-1965) discusses tax reform and the tax bills of 1962 and 1963, among other issues.

Access

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BY DOUGLAS DILLON

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Allan B. Goodrich
Chief Archivist
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Dear Mr. Goodrich:

This is in reply to your recent letter regarding the interviews my husband, Douglas Dillon, did for the John F. Kennedy Library Oral History Project in 1965.

I have looked over the documents you enclosed with your letter, and I agree that there are no longer any reasons to restrict access to the transcripts. As authorized by his deed, I hereby annul the clause that closes Mr. Dillon's interviews for a period of five years following his death that was originally stipulated in the deed.

This letter authorizes the Kennedy Library to open his Oral History interview tapes and transcripts for general research use without restriction.

Sincerely,

A handwritten signature in cursive script, appearing to read "Susan S. Dillon". The signature is written in dark ink and is positioned to the right of the word "Sincerely,".

Susan S. Dillon

C. Douglas Dillon – JFK #6

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Sixth Oral History Interview

with

C. DOUGLAS DILLON

September 21, 1964
Washington, D.C.

By Harvey Brazer

For the John F. Kennedy Library

BRAZER: Mr. Secretary, as far as I'm aware the first thinking on matters of tax policy in behalf of the Kennedy Administration was done by a task force on tax policy appointed by President-elect Kennedy [John F. Kennedy] shortly after the election. Were you familiar at the time of your taking office as Secretary of the Treasury with the major contents of that report?

DILLON: Yes, I was aware of the major contents of that report. It was given to me; I read it and I had an opportunity to discuss it with Professor Surrey [Stanley S. Surrey] who had been in charge of the task force, early in January.

BRAZER: In general, what would you say your reactions to its recommendations were?

DILLON: Well, my reactions were highly favorable, particularly to the investment credit. I had been a strong believer in the need for further incentives to increase business investment and, in my very earliest talks with the President, before my appointment and when he was still President-elect, had told him of my feeling that there should be an improvement in our depreciation practices as well as legislation to increase the incentives to invest. The investment credit seemed to me an excellent answer to at least an important part of this problem. I was also interested because

I'd studied this problem and knew that European countries in particular made use of similar incentives of one sort or another. Some of them used the investment credit. I was sold on the investment credit idea right from the beginning.

BRAZER: Mr. Secretary, when the tax message of 1961 was presented by the President to the Congress in April of that year, within approximately three months of the new administration taking office, the program as it shaped up had certain major objectives. From your point of view, just what was that program designed to do.

DILLON: The program was designed to create an investment incentive through the investment credit that would substantially increase our rate of investment. We intended also to continue with our studies that had been underway for some time in the Treasury and expedite them so that we could get on with an administrative reform of depreciation to complement the investment credit. Secondly, we were attempting to handle a number of rather flagrant abuses that we thought could be readily separated out from a major tax reform bill, repeal of the dividend credit, tightening up on expense accounts,

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withholding on interest and dividends, and taxation of cooperatives, mutual savings banks and mutual casualty companies. And finally there was a very important element in that bill which had to do largely with our balance of payments. This consisted of a whole series of proposals to tighten up on the preferences given to income earned abroad, both by individuals and by corporations. This, along with the investment credit, was probably the most fundamental part of the bill.

BRAZER: Mr. Secretary, is it not surprising that with your extensive business background, you are the principal advocate of a tax program which was received with considerable opposition on the part of the business community? One gathers that the business community was almost unanimously opposed to the investment credit as well as to other features of the program. How do you explain that opposition?

DILLON: I think that the part that was surprising was the opposition to the investment credit. That can be explained on two grounds. In the first place, the investment credit as it was first proposed was highly complex. I had had misgivings about that particularly form of the investment credit prior to its proposal, but they had been overcome largely by the fact that this particular form of investment credit had been tried and was in successful operation in Belgium. Therefore, I thought that if business abroad had seen it work, it might be all right here. This, however, turned out not to be the case, and the complexities were so great that within a couple of months we changed our position and agreed to a much more simplified straight percentage investment credit for all new investment rather than one that was based on the increase in

new investment over some earlier base figure. I think that complication scared off a lot of business people.

Another thing was that the manufacturing businessman was primarily interested in a reform of depreciation. He thought that he had been mistreated for years in the area of depreciation. He feared that the investment credit which was new and which he did not understand was meant as an excuse not to undertake depreciation reform. Even when we said that we were going to revise depreciation regulations, I don't think adequate credence was given to our pledge. It was difficult for the business community to understand that a Democratic administration was about to carry through a reform of depreciation when nothing had been done during the previous 8 years of a Republican administration. Now as far as the rest of the bill was concerned, opposition is easy to understand

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because the bill was closing what might be called either loopholes or special privileges and you would always have to expect business to be against that. A number of the proposals were rather across the board, like the expense account items which applied to all businesses, and also the foreign business items which applied to all those who had any business abroad.

BRAZER: Now in the hearings before the Ways and Means Committee this opposition was voiced repeatedly and strongly. The extensive public hearings were followed by executive sessions in which you participated actively. What was your impression of the reaction of leading members of the Ways and Means Committee to the investment credit and to the revenue raising features of the bill?

DILLON: Well, first of all I would like to make clear that right from the beginning there were certain industry groups that were for the investment credit. They were not large. The machine tool industry was favorable from the beginning because it would help the sale of their products. They understood it, and they immediately mounted a campaign in favor of it. The textile industry was satisfied; they were about to obtain some action on depreciation far ahead of other industries. The coal industry, for one reason or another, seemed to understand and be favorable, and there was a good deal of support from the railroad industry which badly needed new investment. So there were certain industries that were favorable although the big business organizations, such as the Chamber of Commerce and the NAM [National Association of Manufacturers], each had their own pet way of helping business in the tax field and therefore were against everything that was new and different and that they hadn't thought of themselves. It is correct that the bulk of the business testimony was either unfavorable or quizzical, neutral at best, except for the ones I mentioned.

In the Ways and Means Committee I think that the reasons for an investment credit—the fact that investment was growing more rapidly abroad, the fact that we were lagging behind in our balance of payments, and the danger that this posed to our competitive position in the world—were understood and within the Committee the investment credit was

reasonably well received. However, the situation changed and crystallized when the Committee decided that they couldn't complete action on the bill during the 1961 session,

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and adjourned their hearings early in August. Sometime later in August, a decision was taken by the Republican members of the Committee, under the leadership of Mr. Byrnes [John William Byrnes], to make a political issue of the investment credit and to come out against it as a Republican political issue. Why they did this when it had not been a political issue up to that time in the Ways and Means Committee I don't know, but the result of this was that it coalesced with the Democratic majority on the Committee. They had a meeting with the President a few days later after this came out and all subscribed to a statement saying that they specifically favored the investment credit and were going to complete work on the bill early in the next session. And this, of course, insured approval of the investment credit by the Ways and Means Committee since the Democrats were in substantial majority there.

BRAZER: Now were you given any assurances by Chairman Mills [Wilbur Mills] as to the prospects of enactment of such items in the bill as changes in the tax treatment of foreign income, withholding on dividends and interest, and so forth, at that time?

DILLON: Well, at that time I think Chairman Mills was generally inclined to see the importance of withholding on dividends and interest and inclined to favor it. It was perfectly clear by that time that the Committee would not go along with our suggestion to repeal the dividend credit since they tied that in with reform of the high individual rates, and we had more or less tacitly accepted this reasoning because it was logical. On the foreign side, this was really a totally new field and there was a great deal of confusion. As a result we had prepared more or less in bill form the ideas we thought should be in the law and this was published in November with the idea that our staff would work on it and that there would be further changes responding to comment from industry. We would work with industry. It was clear this was going to be difficult. It was also clear that a number of our recommendations would be accepted although the exact final form in which they would be accepted was not clear up until the very end.

BRAZER: Did you feel at that time that it was essential to press forward with depreciation reform as a goal in and of itself and also as a means of insuring enactment of the investment credit?

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DILLON: For both reasons, yes. In the earlier stages when there was a more or less non-partisan consideration in the Committee, there was a great deal of interest in the question as to whether the investment credit was being used as a means of sidetracking our studies on depreciation reform. I stated quite clearly that this was not the case and that we would go ahead just as rapidly as we could.

As we looked into the program and began to get information, it became clear to us that a good deal would and should be done in this area to stimulate investment, which was our major objective. So we wanted to carry this through both for its own sake and because it had become part of our commitment to the Congress that the investment credit was not designed to interfere with progress in the depreciation area.

BRAZER: Now in the fall of 1961, prior to a general revision of depreciation rules and guidelines, you announced a rather drastic change or very sharp change in depreciation as it applied to the textile industry. To some it seemed unusual to select one industry for prior or perhaps special treatment. How do you explain that action?

DILLON: Well, this was the result of a commitment by the President earlier in the spring. The textile industry had been depressed, and it had great difficulties. The President had asked for a series of suggestions as to what might be done to help the textile industry, covering many fields—research, price of cotton, agricultural supports, etc.—and in one area where the Treasury was interested, depreciation reform. And so we had expedited the study we had underway as part of the study of a whole series of industries. We expedited the textile study and were able to get the information that we needed to come to a conclusion. And we carried out the President's pledge to expedite our efforts in the textile field that fall. I had told the Ways and Means Committee earlier in the summer that we planned to do this. I think this was a good portent of the kind of action we were planning in our overall depreciation reform which we saw could not be ready at least until late spring of 1962. It actually was not completed until mid-summer of 1962. But we thought that by putting this textile revision into effect we would give credence to our intention to have a major reform of the entire depreciation area.

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BRAZER: Now the action that was taken was administration action; there was no change in the law. In view of this how do you explain the fact that the Internal Revenue Service had not been able to or did not act on its own if the new shorter lives were justifiable?

DILLON: Well, I think the reason is that this was a bureaucratic matter, and what you were doing was, in effect, asking the cook if his soup was good. The answer could easily be forecast. That's the reason why Treasury attempts to improve the situation during the previous administration had gone astray. They had relied totally on the technical recommendations of a few individuals who had been responsible for the establishment of these lives for depreciation by the Internal Revenue Service. We made clear that we felt that the lives in general were too long, that we intended to shorten them, and that we wanted the best help we could get from the Internal Revenue Service.

We had made a lot of other studies. We had additional overall information of our own from tax returns which gave us something to shoot at. We also had people from different

industries come in and talk with us directly in the Treasury, and we had gotten some very good information in this way. So we were not tied so closely to the Revenue Service experts. As a result we were able to get action. We thought up this new concept of a reserve ratio test which still probably needs to be improved, but as a concept it made it possible for us to accept very much shorter lives on the basis that if companies did not actually use those lives, they would then have to go to a longer period for depreciation.

BRAZER: And the shorter lives together with the reserve ratio test and other features were introduced for all industry in July of 1962. What was your estimation of the business community's reaction to the new guidelines and methods for depreciation?

DILLON: Extremely favorable. Of course, it took a little time. Some of the provisions were necessarily complex. I think full understanding of their advantages is only becoming general now—some two years after they were first introduced. But even when they were first introduced the reception was very favorable. There is a great deal of concern now about the details of the reserve ratio test, details of the transition scheme that was proposed at that time. We are in the process now of restudying these, and it is

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clear that, in this very complex area, some considerable improvements can and should be made. Possibly the date for the application of this test—the summer of 1965—should be put off for a moderate further period. On the whole, certainly business likes the new depreciation guidelines and has responded in a way we had hoped. The same applies to the investment credit even though it was passed in 1962 in a modified version which did not have full force because the credit was used to reduce the depreciable value of new equipment. Therefore, the credit was worth only about half as much as we had proposed. That was rectified in the 1964 Act, and now the great increase in investment by business is clearly due to a substantial extent to the combination of the depreciation changes and the investment credit.

BRAZER: How would you rank the importance of the depreciation reform as among measures taken by the administration in an effort to achieve some sort of, shall I say, cordial relations between business and the Democratic administration?

DILLON: Well, again, I think that's been more important as time wore on. When it first came out, it was looked at, I think, with some surprise. I think industry was quite surprised that this had been done by a Democratic administration. But, as they've seen how it really worked and since they have had tax reduction and the investment credit and have seen how those have worked, I think a feeling has developed that the Democratic administration was truly in favor of promoting the economy through promoting private business and trying to make it possible for business to operate at the highest efficiency. I think that's one of the reasons why there's such a large

sentiment, business sentiment, in favor of the administration today.

BRAZER: Now in January of 1962 the Ways and Means Committee came back and true to its promise took up again the President's tax proposals. What was your feeling about the shape that the bill took as it went from the House to the Senate? Were you fairly well satisfied that this was a good measure, one that represented real progress?

DILLON: Yes, except that the technical form of the provisions for taxation of foreign income were, we knew, deficient. The House had acted very rapidly in this area after the Committee had swung back and forth a number of times. Finally, it did not accept the

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proposals we had put forth the year before. Instead it adopted some provisions that were actually harsher than those we had suggested. We were not at all sure that they were workable, but we were glad to see them in the bill because we knew this would give us an opportunity in the Senate to work on this very complex part of the bill. The rest of the bill seemed very satisfactory. It included withholding on interest and dividends which I thought was very important. It included the investment credit in a fully satisfactory form, the same form that it now is, that is a full 7% credit, and it had adequate provisions for tightening up on expense accounts and such things as mutual savings banks and cooperatives, and so forth.

BRAZER: And then on capital gains treatment of depreciable property you got something except on real estate.

DILLON: Yes, that's correct.

BRAZER: So that your feeling was that as the bill emerged from the House it was a good bill and it incorporated most of what you felt was important.

DILLON: That's right.

BRAZER: Now from the House, of course, you then took the bill before the Senate Finance Committee. Had you had any conversations with Chairman Byrd [Harry F. Byrd, Sr.] that would give you some clue as to what the fate of the bill in the Senate Finance Committee was likely to be?

DILLON: I had had some conversations, but I didn't have much of a feeling from him. I knew that he was generally favorable to some of the foreign taxation provisions of the bill. I knew that he had very real doubts which he had expressed publicly about the investment credit approach. He was inclined to think it was a give-away to business, and that it was not proper to use the tax law to stimulate business investment, but only to raise money. He was also very doubtful about the

withholding provision. So we knew we would have an interesting time in the Finance Committee.

BRAZER: Did you get any more encouraging assurances from Senator Kerr [Robert S. Kerr] or Senator Long [Russell B. Long] or any of the other chief members of the Committee?

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DILLON: Well, I worked very closely on this bill with Senator Kerr, and I had encouraging assurance that he would work all out for the bill. He told me very frankly what were the difficult parts of the bill. The provision that was most difficult was obviously the withholding tax on dividends and interest which was strongly opposed by commercial banks, by mutual savings banks and by savings and loan associations. So there was a very strong lobby exerting great influence against this one provision. With the exception of this one provision, Senator Kerr felt that, with proper work, we could get a satisfactory bill through the Senate Finance Committee. It turned out he was right.

BRAZER: Except that the Senate had at least on one earlier occasion repealed the dividend credit and exclusion. How do you explain the fact that the Senate Finance Committee on this later occasion refused to accept this provision?

DILLON: Well, as I recall it, the Senate Finance Committee had always favored the dividend credit and it had only been repealed by floor action in the Senate. I don't think that situation had changed. There was a strong feeling in the Finance Committee that this provision should not be changed and certainly should only be changed, as was the feeling in the House, in connection with a change in the high personal income tax rates.

BRAZER: Now, in the Senate Finance Committee, as you mentioned earlier, the investment credit was weakened by the so called Long Amendment. In your estimation, was the Long Amendment necessary in order to get the Senate Finance Committee acceptance of the investment credit in any form?

DILLON: Senator Kerr felt it was. He felt it was important to have the support of Senator Long which was tied to this amendment. Also, it answered one of the arguments against the credit, namely, that it was a subsidy in addition to depreciation. We thought it was unfortunate because it cut the stimulative impact of the credit about in half. We were sorry to see it adopted, but it was adopted and we just had to face that fact.

BRAZER: Did you feel at the time that a successful effort might be made in the future to remove the Long Amendment?

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DILLON: I don't know that I felt that. I certainly hadn't given up and we certainly had in mind that at some future date we would try again to remove it. I was pleasantly surprised when we were able to do so less than 18 months later in the Revenue Act of '64 with the concurrence of Senator Long. We were helped a great deal by the tremendous bookkeeping complications that this amendment had created for business and by the general support of business for its repeal. An interesting thing happened when the 1962 bill was before the Senate. By this time there had been a greater chance for business to study the investment credit and there was a much greater receptivity to it than had been the case when it was before the House, particularly after our depreciation reform was made public in July. This became manifest and by the time the bill was being considered on the floor of the Senate there was strong majority support for the investment credit. This was very clearly shown in the fact that it received the votes in the Senate of a majority of the Republican Party even though it had received no Republican votes at all when it was voted on in the motion to recommit in the House.

BRAZER: Well, now there were two other developments in 1962 that occurred or were in the process of development while the tax bill was before the Congress. One of these was the question of whether or not in view of this slowdown in the recovery there ought to be an immediate tax cut perhaps linked with the excise tax rate extension bill which had to be enacted before July 1 of that year. The other was the proposal to provide the President with discretionary tax flexibility. Suppose we take up the first one that I mentioned—the question of whether or not an immediate tax cut in mid-'62 was advisable. I understand that you discussed this in some degree in your interview with Professor Harris [Seymour E. Harris]. But perhaps we might discuss it specifically in the context of what was going on in Congress and what you had in mind for reform in 1963. The impression is that you were among those who opposed an early tax cut in 1962 while the Council strongly favored it. Am I right in assuming that you were in opposition to it?

DILLON: Oh, yes, in strong opposition right along. We had had, right from the beginning, the basic idea that we were going to bring forward a major tax reform bill involving lowering of rates and, hopefully, a broadening of the base. I discussed this with the President-elect before I was appointed and had received assurances of his interest in this. The pledge to do this was

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contained in his tax message of April 1961. At that time we thought we'd get that first law passed in the 1961 session of Congress and would come forth with the major bill the next year. That didn't happen. We had to devote more time to the Revenue Act of 1962 so that the big bill was not yet ready in the summer of 1962. We were planning to work on it that fall.

I felt that it would be a mistake to complicate the progress of the 1962 bill that was presently before the Congress and give up the chance of any tax reform that might be included along with tax reduction in the bill we intended to propose in early 1963. Also, I personally had much less concern than the Council did and than many of my New York business friends had over the stock market decline or collapse which took place in the latter part of May. I felt this was a psychological occurrence largely motivated by excessive fear as a result of the steel price confrontation, and that it would work itself out without slowing up the major momentum of the recovery. The Council at first was much more concerned, relating the stock market action to what had happened in 1929 and many businessmen from New York were also. This was discussed from time to time during the summer with the President, who was naturally very much concerned. Each time it was decided and agreed to put the matter off for maybe a month and see what happened to general business. And as we waited for July and got the June figures and then for August and got the July figures, it became perfectly obvious that there was not any major downward movement of the economy. In fact, the economy was beginning to move back up. So it was perfectly obvious that there was no need for any rapid action.

At the same time I was strongly supported in this feeling, particularly in the latter part of July and August when the economic situation looked a little better, by the Chairman of the Ways and Means Committee, Mr. Mills, who was also strongly opposed to a so-called quickie bill. So the decision was taken to proceed as we had always planned. The President early in June had announced that he fully intended to present a program of tax reduction across the board the following year. We didn't know at that time what the size of the reduction would be but we did know that it would be substantial and across the board. We didn't know the size because we didn't know how much reform in the way of base broadening it was realistic to expect. We had a pretty clear idea of where we wanted to go in rates and that, I think was relatively crystallized everywhere—in the business community, in the labor community and among economists. All of these different

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groups had indicated that a rate scale for personal income of from about 15% to 65% seemed to be either desirable or acceptable, depending on who was talking. So we had something like that in mind from that time on. Also, I think by the summer of 1962 it became obvious that some considerable amount of tax reduction per se would be advisable as a stimulus to the economy.

BRAZER: But you viewed this as a long-range stimulus, not as an anti-recession measure?

DILLON: Oh, very much so. That was our basic idea and that was the idea that was accepted by the President. When the tax cut was finally put into effect, it was put into effect on that basis. And when it was finally proposed, it was proposed on that basis. But, of course, we also realized that it could have the side effect of postponing any recession if one might be in the wind, but that was never the basic purpose. It was too drastic a reform to put forward for that purpose. In that way I

strongly supported the President's request for flexible tax authority to deal with recessions, but that would be quite a different kind of tax cut.

BRAZER: Is it fair to say that President Kennedy in his years in office never did come to the point of favoring a quick tax cut as a means of preventing or reversing a recession?

DILLON: Well, I think he favored the theory if it was really necessary because he made this request for flexible authority, but he never did feel that a situation developed where it was necessary or advisable to use it. I think he was quite skeptical about using it unless a recession was very clearly in view and something was very clearly necessary to stimulate the economy. If that situation had ever arisen, I think he would have favored the use of such a procedure.

BRAZER: Now, in mid 1962 you sent forward to the White House and the White House then forwarded to the Speaker of the House and the President of the Senate a bill together with a letter supporting the bill to provide the President with discretionary tax rate flexibility. This bill never did receive serious attention on the Hill. How do you explain that?

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DILLON: Well, we were busy in the Ways and Means Committee handling the more important bill that was the bill of the moment. That was the Revenue Act of '62 and then later it was the Revenue Act of '64 after it had been proposed in January 1963. This was a proposal to prepare the way for an event that might occur at some unknown time in the future. Also, it cut across a strong feeling of congressional prerogative. I think that it probably served the purpose of promoting discussion of the subject and also bringing out the fact that there would be strong congressional resistance to any such delegation of authority to the President. The basic objective could, of course, be achieved in other ways—for instance, by the Congress setting procedures whereby it would pledge itself to act with great rapidity in the case of a request for a cut in taxes for anti-recession purposes. The Congress might actually agree in advance on the form that such a cut would take although not on the amount. I am very hopeful that sometime in the next few years there will be a serious debate on this whole subject and that some progress will be made. I think that this is a problem for our democratic society here in the United States, which is not faced by most other democracies since they are parliamentary in form. And because of the assured majorities in parliament, a parliamentary government can obtain quick action in a few weeks or a month at most on a request to reduce or to increase taxes. It is precisely because we can't do that and because we necessarily take such a long time to discuss and look into any major tax change that we should set up some procedure so that we can use taxes as a part of fiscal policy to either contain inflationary booms or to avert recessions.

BRAZER: You think then that the principle is acceptable and well established and it's primarily a matter of achieving the appropriate and acceptable procedures. Is that right?

DILLON: I think the principle is more accepted. I don't think it's entirely accepted by the Congress, but I think the chief problem is procedures. I think that if you can get around that, there is a good likelihood that with strong administration support, progress could be made in this area.

BRAZER: Would you be inclined to give it your strong support?

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DILLON: Yes, the problem has been one of relative priorities. The committees can only do so much at any one time and so far they've been very busy. The Ways and Means Committee has probably never had a busier, more productive period than the last four years in major legislation. So, it's a question of finding a time when this has enough importance to fit into the schedule.

BRAZER: Mr. Secretary, before we leave the events of 1962, perhaps we ought to go back briefly to the Revenue Act of 1962 as it came out of the Senate Finance Committee and was finally approved in conference with the House. We had talked about the fact that the Senate Finance Committee weakened the bill in some respects but I think it would be useful if you were to outline some of the specific ways in which in your opinion the bill was weakened and also point to any improvements that they may have added.

DILLON: Well, the chief weakening of the bill was the elimination of withholding on interest and dividends. There was substituted for this a reporting provision which was quite strict and which, as our automatic data processing gets into full use, may possibly prove to be quite effective. However, the simpler idea of withholding was rejected and that was the end of it.

The big improvement that the Senate made in the bill was in the foreign provisions, the very complex foreign provisions which had been inadequately considered in the House. The Senate considered these very thoroughly, had some special hearings on them, and finally wrote the provisions which were accepted in conference and which are the present law. I think they were quite acceptable and a great advance. They did not go as far as we had asked but neither did the basic House bill. Our original idea had been to apply full U.S. tax to foreign earnings in the year they were earned. But the bill did close off the abuse of tax havens and reduce the overall tax incentives to investment abroad to a point where I really feel that tax differentials are no longer of much importance in any decision to invest abroad.

And this, of course, was also helped by the passage of the investment credit and by depreciation reform which made it relatively as attractive tax-wise to invest in the United States as it was abroad. So I think that with this combination a substantial forward step was

taken in a very difficult area. It was the Senate Committee which did this and it was a very good job.

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BRAZER: Mr. Secretary, you'd been accused through your advocacy of a repeal of deferral on foreign earned income of discouraging the free movement of capital in the world. The suggestion has been made that these proposals and the contents of the bill will have the effect of discouraging movement of American capital abroad. What is your response to this accusation?

DILLON: Well, it's perfectly clear from what's happened since the bill was passed that movement of capital hasn't been discouraged at all except that it has stopped moving into the tax havens, such as Switzerland. The setting up of the new tax haven companies has for all practical purposes come to an end. But the flow of major investment abroad hasn't been reduced at all. In fact, it's been slightly larger, if anything, than before. So the provisions have no effect that way. I don't really think that the provisions we originally recommended on deferral would have had any major effect that way either. I think they would simply have equalized the tax opportunity. Many other countries don't have this special deferral, although in the case of Great Britain they do have something similar. So I don't think that it would have had the effect that business representatives said it would have, but I must admit that this was difficult for the committees of the Congress. The businesses that were active abroad, very many of them, came in, and they made extreme statements about the terrible effects this would have on their operations.

BRAZER: After approximately two years of observation, do you think that the expense account provisions of the 1962 Act have done anything toward eliminating so-called abuses of expense account living?

DILLON: Oh, I think they've done a lot. One thing they've done, they've allowed corporations to have an excuse for tightening up on their own employees where they have long wanted to and that's been done. I think there's no doubt that under these provisions there's nowhere near the volume of abuse in this field that was present before. They have not had the effect of closing down all the restaurants as some people have said they would although there certainly was an adverse effect on luxury restaurants for awhile and maybe even some continuing effect. But I think that was a small price to pay for this substantial increase in equity.

BRAZER: Have you any evidence yet as to the effectiveness of the alternative to withholding on dividends and interest that was contained in the Revenue Act of '62?

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DILLON: No, we don't have any real evidence as yet, and I don't expect we will have any for 3, 4, or 5 years until we are really in full swing on automation of tax returns, when we can really match up information returns and tax returns. This really won't be in effect all over the country for another two years or so. We're beginning in 1967. In that year, which will cover the tax returns filed for 1966, full automation will be in effect. There should then be a possibility of matching up information and tax returns and really seeing what the results are. But the results of this will not be available for statistical analysis until sometime late in 1968. So we've got about four years to wait until we can really begin to answer your question.

BRAZER: Now, during the latter stages of the debate on the 1962 Revenue Act, what was going on in the Treasury with respect to the promised broad reform program that the President had announced would be presented early in 1963?

DILLON: Well, during the latter stages of the debate we were working hard on two things. One was the cost of an individual tax reduction to the 15-65% area, and the other was conducting as detailed a search as we could for areas in which loopholes could be closed and additional funds could be raised to offset the revenue cost of rate reductions. It was at this time that it became obvious that if we were going to reach the 15-65% level which we felt was very desirable, in order to increase the incentives to work and invest and to promote new enterprise, we would have to have a very substantial overall tax reduction. And it also by that time seemed that such a substantial tax reduction could be justified on economic grounds. So these two matters came together in a conjuncture that seemed very favorable.

BRAZER: This was a happy coincidence.

DILLON: Happy coincidence, yes. And we found out that in the area of reform, unless we were ready to take on a number of things which were not clear, such as the deduction of interest payable on mortgages or the taxation of state and local bonds, both of which could have very serious adverse economic effects on the country, there were no truly large new sources of tax revenue to tap.

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What was left in the way of loopholes, while they may have been many in number, were not very productive of income. We did come up with one thought, which was a floor on personal deductions, a 5% floor, which would have given us about \$2.5 billion additional in taxes by reducing personal deductions equivalently. We made that proposal, but it was not accepted. Therefore, we had to change the rate scale to reduce our revenue loss. So we wound up with the top rate of 70% instead of 65%

BRAZER: Before we go into the specifics or substance of the 1963 Tax Message, perhaps one of the outstanding features of that tax message was its advocacy of tax reduction of some \$10 billion. Now it's been alleged in some circles, publicly and privately, that the impetus for a tax cut of this size, at any rate \$5 to \$10 billion, came primarily from the Council of Economic Advisers, that the Treasury accepted the reduction of this dimension with reluctance and only because it felt that this was the price to pay in order to get reform. Does this conform with your view of the development of events?

DILLON: No, it does not. I can understand maybe how that thought arose in some circles. Probably it was because of the Council's advocacy of a large tax reduction early in the summer of 1962 although I don't remember whether they actually used precise figures at that time or not. I don't recall that they did.

BRAZER: If they did, their figure was a lot lower than \$10 billion.

DILLON: Yes, I would think so. As I recall, when we were figuring early that summer on a tax reduction, the figure we had in mind was somewhere in the neighborhood of \$5 billion, which did not shock us at all. The \$10 billion figure first came to mind in the fall of '62 when we had fully priced out the cost of a reduction of 15-65% and seen the fact that there was very little that could be offset against it. At that time it became clear that we were in the general neighborhood of \$10 billion if we were going to have any sort of corporate reduction as part of the bill. We had always felt that there should be both corporate and personal income tax reduction. This had been, as far as I was concerned, a basic objective ever since December of 1960 when I had spoken to the President about it before his inauguration and before my entering

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into office. And so certainly it was nothing that was pushed on us from the outside, or pushed on me from the outside. I know the Under Secretary felt the same way, and I am sure that our whole Treasury organization felt that this was desirable although nobody was aware of the exact figures until we reached the fall of 1962 and found out what was needed to achieve our objectives.

There certainly was never any time when we were reluctant about this tax cut in 1963. We were reluctant about timing it ahead into 1962, but not about 1963. The only other difference that I know was again a minor one with the Council, but early in 1963 there was some uncertainty, a couple of months of slight uncertainty, regarding the economic situation. At that time the Council became concerned that full discussion of the reforms that we had suggested would take too long and the tax cut might be lost. They suggested that the bill be split with simply a tax cut first and then a later try to get reformed measures. We resisted that very strongly because we felt that was the wrong procedure. We didn't feel it necessary from an economic point of view either. And, luckily, we turned out to be right.

BRAZER: Would you say that your proposal, as you were prepared to present it to the President, for a \$10 billion tax cut came as a surprise to some elements in the administration who were concerned with fiscal economic matters?

DILLON: Well, it sort of developed gradually. So I don't know whether it was a surprise or not. Of course, there may have been some who felt Treasury would not make a recommendation of this kind. By that I mean that some outside of the Treasury who had not been following the way we'd been discussing this internally may not have realized the strength of our desire to get rate reduction, to stimulate the economy, and to increase incentives. And so it may have come as a surprise to some. I wouldn't know about that.

BRAZER: To what extent were the developing Treasury proposals, both with respect to structural reforms and rate reduction, as well as overall net reduction? To what extent were these discussed with or cleared with other agencies, or was it purely an internal matter?

DILLON: Both these tax bills were developed purely internally in the Treasury and only at the very end of the process were they given as a package to the Budget Bureau who then brought in the

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Council of Economic Advisers and the White House advisers to look them over. As far as I can recall, there weren't any substantive changes made in either of the two bills from the packages originally suggested by the Treasury, certainly no changes of any moment.

BRAZER: So that the \$10 billion tax cut was a proposal that was developed in the Treasury which might certainly have developed irrespective of the views being presented by other agencies.

DILLON: Oh, I think it developed entirely irrespective of that. We welcomed the support we had from other agencies, but we developed the bill itself. We conceived of the idea of the split in the first bracket that would reduce the lowest rate of 14% rather than 15%. We also conceived the idea of the minimum standard deduction which was of special benefit to low income people and which could be given without too great a revenue loss. In fact, the whole bill was a product of Treasury thinking.

BRAZER: Well, now we have the \$10 billion cut and as you pointed out this was a net cut resulting from tax rate reductions plus certain liberalizations adding up to something over \$13 billion less some \$3 billion reform. Some observers looking at the President's Tax Message were perhaps disappointed to find that in two areas that had long been discussed under the heading of tax reform, namely,

changing depletion allowances and taxation of municipal bond interest, there was nothing to be found in the tax message. Take, now, municipal bond interest first. It's been said that Secretary Dillon is the first Secretary of the Treasury since Andrew Mellon's [Andrew W. Mellon] predecessor, who had not advocated—there may be one or two exceptions to this but, in any case, most of the Secretaries of the Treasury had apparently advocated repeal of the exemption of municipal bond interest. How do you explain this omission in what was purported to be a broad thorough-going program of reform?

DILLON: Well, personally, I was opposed to any change in this area. I would concede and would agree that if there never had been such special exemption we would probably be better off today. However, our whole system of financing for our states and municipalities is based on this tax exemption. As the years developed and the needs of municipalities grew greater and financing grew greater, this became more and more and more important, and by the 60's this was a close to a \$10 billion a year matter. And it is clear that a great many

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smaller municipalities couldn't have sold bonds or borrowed at all without this tax exemption. Therefore, I felt, from the point of view of its effect on the economy, which is a totally different question from tax equity, that this was something that we just could not afford to tinker with. I didn't find a great deal of opposition to that attitude on that particular basis.

As far as depletion is concerned, there the great difficulty was that when one wants to change the rate there was no logic to support any particular rate as being proper. After studying the matter very carefully, we couldn't find any logical rate, so instead we made some suggestions that would have tightened up on the use of depletion considerably. Our suggestions dealt with the difference between depletion that was 27-1/2% of gross and the 50% of net cut off. We did have those recommendations in the bill. However, they were not accepted except for one relatively minor adjustment which increased revenue by about \$40 million. But even this was remarkable in the fact that it was the first increase in the taxation of the oil industry since the 1920's.

BRAZER: So you do feel that some improvement in equity was achieved in this area?

DILLON: Yes, mostly at the expense of the larger companies which was probably where it was most needed.

BRAZER: In connection with municipal bond interest, you mentioned the physical financial and economic aspects as well as touching on the equity question. What about the political feasibility of the Treasury move to repeal the exemption?

DILLON: Well, I think it's totally infeasible politically, largely for the economic reasons which I mentioned. All Congressmen come from areas where towns and municipalities depend on the sale of bonds to build their schools or their waterworks, one thing and another, and all of them feel very strongly about anything that would interfere with this. So I think you would have very little support in the Congress for such action. Of course, if you didn't have this setup, you would have to rely much more heavily on central government subsidies to the states to get things done, which would mean higher central government taxation and more funds being funneled to the states.

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BRAZER: Since this interview is being prepared in order to facilitate the task of future historians, would you be willing to venture a guess as to the prospects for tax reform in this area for the future? Do you think these prospects get worse as time goes on?

DILLON: I can't see them improving because of the increasing need for funds of the states and municipalities. As long as their needs increase, they will be more jealous of their ability to tap the financial markets which they can do because of this exemption from taxation. They would be even more desirous of retaining their exemption. I can't see any near term time when that would be changed. The only thing that could change it would be a basic and complete overhaul and change of our tax system whereby a lot of funds were earmarked by the federal government to go to the states and municipalities. Even then, I think, this would be difficult. I don't know how you could do this in a way that would guarantee that the individual municipality could get funds whenever it wanted without someone else having to say yes or no. They now have that freedom under the present system as far as the marketing of municipal bonds is concerned.

BRAZER: Would you say that the present arrangements for taxation for the extractive industries are equally well entrenched and likely to continue in effect through the future?

DILLON: I think there is probably more chance for a change there because there it is a question of the special interests of certain industries. There is a good deal of opposition on an equity basis from parts of the country where these industries are not so important. So I think there is a good chance there can be improvement of a kind in this area.

BRAZER: You go into the substance of the recommendations that were contained in the tax message. Clearly it is not necessary to discuss the details of each of the provisions because your views are extensively well documented, in public hearings, speeches and so forth. We might perhaps start with some of the recommendations that may be regarded, perhaps, as more radical than others. It seems to me that the proposals in the capital gains area fit that description. Perhaps the most radical of these was the proposal to introduce what the profession calls construction realization at

death. It seems to me that your views on this proposal should be of particular interest.

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DILLON: I was convinced that a good case, from an economic point of view, mobility of capital, making our economy more fluid and therefore promoting investment, had been made for reducing the 25% capital gains tax and for reducing capital gains taxes in general. However, there was a matter of equity which was equally important because of this very favorable rate. I felt that any reduction in capital gains rates should only be coupled with some sort of taxation of capital gains at death. There didn't seem to be any equity in the ability of some people to avoid capital gains taxation entirely, as they presently can if they hold securities or property until death. So I advocated a system whereby tax rates would be reduced on capital gains and at the same time there would be some sort of taxation of capital gains at death, or a carry-over of value which may not be quite as good but would have been acceptable. These two proposals would more or less have offset each other on a revenue basis. I thought, therefore, that it would give us a much fairer regime and also a regime that was more conducive to switching investments and to economic growth.

BRAZER: Another major recommendation in the capital gains area that you advocated was extension of the long-term holding period from six months to a year. What was your justification for that?

DILLON: Well, that was also part of the same thing. I thought that a one year holding period was a more reasonable basis. The six-months basis had been enacted primarily in the interests of trading on the New York Stock Exchange. It didn't seem to me that that was of any great importance. The twelve-month proposal was part of this overall package to justify a reduction in rate. Of course, as the bill evolved, none of this was passed. The House finally passed the reductions in capital gains rates and didn't pass the part of the bill dealing with constructive realization. We were able to have the Senate remove the reduction in rates from the bill. Although desirable from an economic point of view, it was certainly most inequitable and, therefore, we were opposed to it. The reduction in capital gains rates was removed in the Senate, and the Conference Committee accepted that Senate action so the whole area of capital gains remains unchanged and open. I still hope something like this can be done, but it seems clear from the discussion in the House and the Ways and Means Committee, and also in the Senate that anything that may be done in the area of constructive realization will have to be tied in with a reduction

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and reform of estate taxes. That is, of course, another large subject. I would hope that sometime in the next few years the administration will come back to this because I think it is something that can and should be done.

BRAZER: The thorny area of capital gains involved the so-called statutory gains on things like profits from the sale of standing timber, coal or oil leases, and items of that kind. What was the feeling lying behind these recommendations?

DILLON: These items certainly didn't seem to be true capital gains. They seemed to be special privilege for various reasons. They were recognized as such and we didn't see there was any reason in equity for them to continue. I never felt personally too strongly about these items because when you added up the total amount of revenue involved, it was quite small. Naturally, the individuals involved felt very strongly about these. The one that had the most revenue was the timber benefit and repeal of that was, of course, opposed by everyone who had any interest in standing trees on their farm or in the timber industry. You find that practically all over the country, so we found that there was practically no support for that change in either branch of the Congress.

BRAZER: Looking at the record of your testimony before the Ways and Means Committee, Congressman Baker [Howard H. Baker, Sr.] questioned you while you were in the process of delivering your testimony on the recommendation having to do with the repeal of capital gains treatment for coal royalties. Did this line of question at that time suggest to you that the recommendations in this area were going to receive rather short shrift?

DILLON: Yes, we agreed right at that time that we would drop the coal royalty matter because as I said all of these items were rather small. That item, as I recall, we estimated would raise maybe \$2 million, and when you are talking about a \$10-1/2 billion bill that had a lot of problems in it, it just wasn't worth wasting a week or so in debate on a \$2 million item.

BRAZER: How does this jibe, however, with the action taken by the Senate Finance Committee somewhat later to provide the same treatment for iron royalties?

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DILLON: That was taken by the House and the Senate concurred in it. It was an item we opposed, but it was one that the Committee had apparently decided on and they overrode us. We tried to get it changed in the Senate but were unsuccessful. We think it's a broadening of the loophole which was entirely uncalled for, but again I think the total involved was something like \$4 or \$5 million so it's not a major item.

BRAZER: With this tax treatment extended now to coal and iron royalties, to royalties on patents and various other forms of income, do you see any danger of this kind of preferred treatment extended to other kinds of

income in a manner that will make this important?

DILLON: No, I would hope not. Certainly when it was extended to iron ore it was made very clear by the committees that this was not meant to be used as an excuse for other sorts of commodities or items to come in and get the same treatment. It was said that this was unique and the record was pretty clear on that. I think that unless it is tied in with a big bill like this, any individual bill of that nature would be subject to presidential veto. So, I don't think the chances are very great of its being extended.

BRAZER: Could you, for example, Mr. Secretary, conscientiously object to capital gains treatment of royalties on copyrights in view of the existing treatment of royalties on patents?

DILLON: I'm not aware enough of what that situation is. Certainly if it is widening a loophole I probably would object and say the way to answer it is to tighten up the others.

BRAZER: I think that covers that area. Now we go into the other aspects of the program we talked about, the rate structure and the capital gains area. The major revenue raising provision in the program was the 5% floor under personal deductions. What kind of reception did that get? Were you surprised?

DILLON: We were uncertain about the reception that would get when we put it forward. We thought it was worth trying. We thought it would be an improvement, that it would broaden the base and reduce the escape from taxation through these many special preferences, but our fears were more than realized when it was attacked violently by educational institutions, by charitable institutions, and by churches.

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It very soon became obvious that, as a whole, it did not have a chance. However, we salvaged from it one area which was the deductibility of miscellaneous state and local taxes, not counting state income taxes, state property taxes, or general sales taxes. The gasoline tax was also excepted. So we did raise some \$400 or \$500 million in this area, which is something, although it was not as much, or anywhere near as we would have liked.

BRAZER: One other proposal that would have raised some amount of revenue is revision of—or would have made for some change, perhaps not raising much revenue—is the tax treatment of older taxpayers. What was the Treasury position?

DILLON: Again, we came forth with a plan that would have improved the situation of older taxpayers, but as part of our improvement, we planned to take away some of the special preferences they currently had and give them other preferences which would more than outweigh those taken away. But, like many of these things which are complex, this was not understood and was not supported by elderly people as a group because they were afraid they would lose something. They didn't understand what they were really going to get. The total package was going to cost something like \$300 million but without their help and support this was abandoned. This decreased the amount of revenue loss which was involved in the bill, and helped to offset what we were losing from the failure of the 5% floor.

BRAZER: Did this demonstrate to you that it might be just as hard to give favors to taxpayers as to take them away?

DILLON: Yes, it is sometimes, when they are at all complex and if it is part of a simplification procedure. Everyone likes to keep everything they have, no matter how complex it is, and, while everyone is supposedly in favor of simplification, no one wants simplification at their own expense.

BRAZER: Do you see any parallel between this and the investment credit?

DILLON: Yes, I think there was some parallel, although in the investment credit business eventually came around to support it. I am sure the old people would have supported this and been very happy with it if they could have ever lived under it and understood it, but they never got that far. But the parallel is exact. We were trying to help them and they didn't want help.

[END OF INTERVIEW]

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