

DIARY

Book 22

April 21 - April 30, 1936

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April 21, 1936

Mr. Chen met again today with the Secretary. Also present were Ambassador Sze, Mr. Taylor, Mr. Lochhead and Mr. White.

The following is a record of their conversation.

HM, Jr.: I hear you have a message for me.

Mr. Chen: In your first conference you asked me what is the policy of the Chinese currency. I answered that China would keep the present system. We would have no change for the future. The reason for that is that we cannot afford another change and we must have a success of the present system. In the months from June to October we were asked to give relief to the people, the small manufacturers who are victims of the depression, but the Government has no money. I am on that Committee. This picture is so vivid and if we should be compelled to have another change of currency, we will have a collapse. With the present change of currency, we have so many reforms, such as the reform of the Central Bank of China. We must help our victims of the depression first. We must have about six more months' time in order to make a success of our monetary change.

I think you already have a full picture of the Chinese situation. I want to talk to you about the sale of silver.

HM, Jr.: I do not understand what you have on your mind.

Ambassador Sze: What Mr. Chen wants is to insure that the currency will be able to withstand any attacks that might happen within the next six months.

HM, Jr.: In other words, do I understand you want to know how much silver we are ready to buy? I threw out a suggestion sometime ago, but right now I cannot go into it and I am not prepared, because I just thought you wanted to hand me a cable which you had received from Dr. Kung. I have to leave in about two minutes for Mr. Howe's funeral. I am sorry I am not prepared now for a long discussion.

Quite frankly, before I get down to the question of how much silver we are going to buy, I want an answer to the question which I have put to you, namely: Are you going to continue to tie your money to Sterling and how much silver are you going to put into your coins? Those are the questions

which we put to you and I want these questions answered first. I am not making any suggestions to China to change her method of management of her currency, but I suggested that you free your currency from any other currency. Actually, you are not tied to Sterling, but you work between the Dollar and Sterling and I am suggesting that if that is the way you do manage your currency that you say so publicly.

Frankly, I think the next move is up to you. The two things that I would like to know are whether you can free yourself from Sterling and how much silver will you put into your subsidiary coins. I appreciate your economic difficulties at home. We have had ours here and I understand, but before I can give you an answer on how much silver we will buy, you must answer our questions first. I must have the answer in writing.

I indicated to you at one of our meetings that we might buy 5,000,000 ounces a month for the next eight months, but again I repeat that before doing that I must have my questions cleared up first before we go into any more discussion.



HEADQUARTERS

**SECRET**

TREASURY DEPARTMENT

UNITED STATES COAST GUARD

WASHINGTON

21 April, 1936

From: Spagent, Shanghai, China.  
To : Secretary of the Treasury.

Message from Professor Buck. Kung again expresses appreciation for your cordial welcome Chinese delegate, your sympathetic interest and gives reassurance that China has no intention of selling all her silver and that she will use silver in 50 cent token coins and as reserve, but that another sale of silver is necessary for larger foreign exchange stabilization fund. He also states no danger of inflation because of unbalanced budget, especially since China has had unbalanced budget last 20 years and still has never resorted to printing press and he is determined not to inflate in future. He again expresses desire for your help in adjusting wheat loan at this acutely difficult time.

**SECRET**

# TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE

4  
April 21, 1936  
MM

TO Secretary Morgenthau

FROM

Subject: China - New Silver Coins

The Chinese Government is considering the issuance of 50-cent and yuan coins with a silver content. The minting and circulation of such coins would provide an additional demand for silver, and would prevent the complete elimination of silver coins from China's monetary system. Both of these results are desirable from the point of view of the United States, and, if issued under the proper conditions, would be beneficial to China as well.

- I. What kind of silver coins would it be advisable for China to issue?
- II. Under what conditions should they be issued?
- III. How many can be conveniently absorbed into circulation?
- IV. How many could the mints in China coin?

I. What kind of silver coins would it be advisable for China to issue?

The coins have to satisfy three requirements:

(a) They must contain enough silver so as not to permit the profit from counterfeiting to be great.

Successful counterfeit coins must contain almost the same amount of silver as the legal coin, else they are easily detected. Because of the lack of effective centralized control possessed by the Nanking Government over her borders, as well as within China, counterfeiting is apt

to be a more serious problem there than elsewhere. The standard of living is so low, the kingdom so large, and the political situation so disturbed that it would be a relatively easy task for counterfeiters to operate either within the country or within the contiguous area.

Therefore, the higher the silver content, the less counterfeiting will the Government have to contend with.

(b) Coins ought not to contain so much silver as to make their bullion value equal to their nominal value so long as there is no guarantee that the price of silver may rise or the yuan exchange fall. To have a silver coin with a metallic value equal to the nominal value would expose their coins in circulation to the possibilities of disappearance in the event the price of silver rose, or yuan exchange fell.

The greater the silver content of the coins, the less will the price of silver have to rise, or the price of yuan exchange have to fall before its metallic value exceeds its nominal value. A rise in the price of silver would, however, provide some offsetting advantage. China could sell some of her silver holdings at the higher price and thus increase her excess reserves as well as her foreign exchange. A drop in the exchange rate would likewise increase the value of her reserves in terms of yuans. Yet either change -- after the melting point were reached -- would increase exports of silver coins, or smuggling if restrictions were placed on exports.

Care must, of course, be exercised not to make any suggestion with regard to the specific silver content of the new coins, or a maximum silver content. To do so may be tantamount to informing China that our policy is to keep the price of silver below that point. It would probably be so interpreted, and the United States would then have thrust upon it the responsibility of seeing that the price of silver -- so far as she had control over it -- did not rise above that point. Even though it may be believed that the price of silver will not rise beyond (say) 75 cents an ounce, it may not be expedient to make that official view public by advising a safe maximum of silver content in China's new coins. For this reason, it is desirable that it is clear to all concerned that the Chinese Government alone is making the decision as to the silver content of the new coins.

(c) The size of the coins must be adapted to convenience and -- under the present circumstance -- to tradition.

A yuan coin of a much smaller size than the old one may create an unfavorable impression among the people. On the other hand, the larger the coin the higher has to be the silver content in order to achieve a desired silver color. Since the current yuan coins are about the same size as our silver dollar (yuan is 411.9 grains, and U. S. dollar is 412 grains), the difficulty of obtaining a good silver color would be an important factor in determining whether so large a coin should be minted.

II. Under what conditions should the new coins be issued?

It depends on the silver content. If the metallic value is to be close to the nominal value, no restrictions on the issues are necessary. There would be no danger of over-issue. The Government would, in fact, be reluctant to issue them, inasmuch as their cash reserves would be reduced by every yuan coined and issued.

The lower the silver content, the greater the seigniorage profit to the Government. If the content goes below 60 per cent in value, there is the additional incentive for issuing more coin, in that each coin issued adds to the excess reserve.

With a financially strong and politically stable government, it is doubtful whether any restrictions on issues of subsidiary coins would be necessary. But in the case of China there are reasons why some restriction - either in form of a set maximum, or in the legal requirement of a specie reserve against the issuance of one-half yuan and yuan coins - should be imposed.

(a) China being long accustomed to using yuan coins, the amount that could be absorbed into circulation is very high.

(b) The Chinese Government is badly in need of funds, and if the seigniorage is to be high, the temptation would be strong to issue as many of those coins as possible.

(c) The lack of assurance existing in many quarters in the success of a managed currency for China under present conditions might be enhanced if a new program of coinage were adopted that appeared to present possibilities for easy inflation.

(d) So long as there exists danger of sharp depreciation (e.g., outbreak of hostilities, or monetary breakdown) it is safer for the Government to have a greater proportion of notes to silver in circulation, with the metallic reserves in the Government banks.

(e) Monetary adjustments (e.g., devaluation) are easier to execute if the money in circulation does not contain coins whose metallic value is high.

There are thus disadvantages to unrestricted issues of low metallic value silver coins, or of high metallic value coins, though the disadvantages differ.

To avoid the disadvantages of either the low or high silver content, a compromise can be made.

Let low silver content coins be issued (say 40 to 50 per cent metallic value) and a legal reserve in silver, gold, or foreign exchange be required on all issues above a certain predetermined sum - a reserve which would reduce the seigniorage on issues above that sum to possibly 15 per cent.

The advantages of such a requirement would be:

The danger of over-issue would be eliminated, and therefore confidence in the yuan would not be lessened.

The danger that the bullion value might in the future exceed the nominal value would be reduced.

In case of grave emergency the reserve requirement could be reduced and thereby liberate more funds for the emergency. Alterations in the exchange rate, or in the nominal metallic value of the standard unit could be more easily made.

The one possible disadvantage would be that to avoid counterfeiting, or discoloration, it would probably be advisable to reduce the size of the yuan coin to something approximating our half dollar.

III. How many yuan and half-yuan coins can be conveniently absorbed into circulation?

The prospects of circulation of the new coins seem good. It is believed that such coins would be quite popular in China, and it is likely that the community could absorb 200 to 300 million yuans of such coins during the course of the next twelve months.

Both Mr. Chen and Mr. Koo express the belief that the Chinese Government would prefer to issue the coins rather than the notes, inasmuch as there would be some saving in silver reserves, as well as some seigniorage profit, provided that the issue of such coins was subject to reasonable restrictions devised to prevent over-issue.

IV. How many new silver coins could the mints in China coin?

In the fall of 1934 the Central Mint of China was turning out about 8 million yuan coins a month.

No figures are yet available as to the proportion of the capacity

Secretary Morgenthau - 5 -

that is now being utilized for the coinage of the new token coins. In the event a decision is made to coin large amounts of yuan and half-yuan coins, it will probably be necessary to at least have most of the blanks (as well as the dies) imported.

Value of silver content of new Chinese  
coins under varying assumptions.

Fineness	Fine silver content:		Metallic value			
	<u>1/</u>		Price of silver 45 cents	Price of silver 65 cents	Yuan exchange 40 cents	Yuan exchange 30 cents
	(Grains)	(Ounces)	(Yuan)	(In U. S. dollars)	(Yuan)	(In U. S. dollars)
200	82.40	.1717	.2577	.0773	.3720	.1116
250	103.00	.2146	.3220	.0966	.4650	.1395
300	123.60	.2575	.3863	.1159	.5580	.1674
350	144.20	.3004	.4507	.1352	.6510	.1953
400	164.80	.3433	.5150	.1545	.7437	.2231
450	185.40	.3862	.5793	.1738	.8367	.2510
500	206.00	.4292	.6437	.1931	.9300	.2790
550	226.59	.4721	.7080	.2124	1.0213	.3064
600	247.19	.5150	.7727	.2318	1.1133	.3340
650	267.79	.5579	.8370	.2511	1.2087	.3626
700	288.39	.6008	.9015	.2704	1.3017	.3905
750	308.99	.6437	.9657	.2897	1.3947	.4184
800	329.59	.6867	1.0300	.3090	1.4880	.4464
850	350.19	.7296	1.0943	.3283	1.5807	.4742
900	370.79	.7725	1.1587	.3476	1.6737	.5021

Treasury Department, Division of Research and Statistics.

April 21, 1936.

1/ Based on the present gross weight of the yuan which is 411.99 grains. The present gross weight of the United States silver dollar is 412.50 grains.

## AMERICAN RED CROSS

April 21, 1936

Bell presented request for approval by Secretary of investment of ARC Endowment funds in commercial stocks. HM, Jr. advised Bell to write them a letter saying he could only recommend investment in Government securities.

May 5, 1936

Legal opinion on question of whether Secretary of Treasury may resign from Board of Trustees of American Red Cross furnished by Legal Division.

May 29

HM, Jr.'s first and second letters this date to American Red Cross that he could only recommend Government bonds for investment funds of Endowment Fund of American Red Cross.

June 19

Gaston's conference with Mr. Early in which Early said circulation of Secretary's letter would be direct attack on securities mentioned in Secretary's letter.

July 23

Letter from American Red Cross enclosing vote on proposed sale of certain securities held by American Red Cross Endowment Fund.

July 25

Treasury report of holdings of Government securities.

Aug. 26

Conference of Secretary with Mr. McClintock of American Red Cross. HM, Jr. explained his position as Secretary of Treasury with respect to investment of trust funds. McClintock said Board of Trustees agreed with Secretary. Secretary expressed intention to resign from Board of Trustees.

Sept. 1

Report of meeting between Gaston and Bell with Mr. Early on August 25. Latter suggested HM, Jr. write substitute letter to Admiral Grayson making no reference to particular securities.

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Sept. 9

Notice of meeting of Board of Trustees of Endowment Fund of American Red Cross on October 7, 1936.

Sept. 11

Letter to American Red Cross - meeting of Board of Trustees to be held in Secretary's office October 7 is agreeable to HMJr.

Oct. 1

Analysis of portfolio of Red Cross Endowment Fund and Standard Statistics' report and recommendations.

Oct. 5

Press Conference in which Secretary outlined his position for newspaper men.

Oct. 7

Meeting in Secretary's office of Board of Trustees of American Red Cross Endowment Fund. HMJr. stated his position as Secretary of Treasury with regard to investment. Question of resignation deferred.

Tuesday  
April 21, 1936

Operator: He hasn't come in yet, they expect him any minute.

HMjr: If he comes in the next ten minutes I'd like to talk to him.

Operator: All right.

HMjr: Hello -

Operator: Go ahead.

W. R.  
Burgess: Hello -

HMjr: Hello -

B: Good morning, sir

HMjr: How are you? Burgess -

B: Yes, sir

HMjr: Can you explain yesterday's drop in the Stock Market?

B: No, I don't think there was anything special.

HMjr: You don't?

B: It was just they're getting a little bit tired -

HMjr: The gossip that we hear up here - and I'll pass it along to you and I'd like to have you check it -

B: Yes

HMjr: That it's getting out that something is going to be done on excess reserves -

B: Well, that - that just came out somewhere.

HMjr: Yes

B: But - after our annual report perhaps.

HMjr: Yes

B: But I don't think that amounts to very much.

HMjr: You don't?

B: There's also - there's also a good deal of talk about the French elections you know.

HMjr: I see. Well, let me ask you this -- there's not - it

isn't foreign selling, particularly?

B: No - last week, for which we have figures, the foreigners were heavy buyers.

HMjr: They were?

B: Now, of course, we haven't got the figures -

HMjr: No

B: - for this week yet.

HMjr: Yes

B: But I haven't any reports to that effect.

HMjr: I see, all right.

B: I rather think on excess reserves the market thinks the other way - that there wouldn't be anything done.

HMjr: Yes

B: Although I think possibly our reports had a little effect the other way.

HMjr: Yes

B: I don't know.

HMjr: All right.

B: It's a very hopeful tendency to have the market a little bit -

HMjr: Oh, yes -

B: down

HMjr: I'm not worrying about its going down - I just, I'm curious as to the reason, that's all.

B: Yes, that's right, yes -

HMjr: No, no, I'm glad to see it go down.

B: Yes, yes -

HMjr: All right

B: First rate

HMjr: Goodbye.

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Tuesday  
April 21, 1936

HMjr: Hello, Marriner -  
Marriner S.  
Eccles: Yes

HMjr: How are you?

E: I'm all right, how are you?

HMjr: I'm fine. Marriner, we're talking over our financing and the Treasury has come to the conclusion that there is no sense having a meeting tomorrow because - until you fellows make up your mind what you are going to do on excess reserves. So I'd like to postpone the meeting for a week.

E: Well - do you - do you want to know definitely just what - what the exact - action the Board would prepare to take?

HMjr: Well, I'll put it this way. I'd like to know whether the Board is going to do anything between now and the first of July.

E: Yes, I see.

HMjr: That's what I'd like.

E: It wouldn't be enough to say that we wouldn't - if we did do anything - that action would be taken, the amount of the excess reserve fixed and the date fixed not later than May fifteenth?

HMjr: As to the - effective, you mean?

E: Yes, well, I'm just saying that - would it be sufficient if we said that if anything is done that would be done, if not nothing would be done until after July?

HMjr: Now, wait a minute, repeat that, I don't get it.

E: I say, if we said -

HMjr: Yes

E: - if we agreed -

HMjr: Yes

E: that if anything was done -

HMjr: Yes

E: it would be done at the date fixed -

HMjr: Yes

E: Not later than May fifteenth -

HMjr: Yes

E: If it wasn't done at that time -

HMjr: Yes

E: and the date fixed so that it went into effect by that date -

HMjr: Yes

E: Nothing would then be done until after July first.

HMjr: That - from our standpoint that would be entirely satisfactory.

E: Yes, well now, I'm going to have a meeting of the Board this morning.

HMjr: Yes

E: And I'll be able, I'm very sure, to get a commitment to that effect -

HMjr: Yes

E: Now - with reference to talking to Landis this - this thought had occurred to me - that we'd like to get Landis' views.

HMjr: Yes

E: So - just as we did when we put out regulation "U" which was - provided for the margin -

HMjr: Yes

E: on the collateral loan.

HMjr: Yes

E: So why wouldn't this be the best thing to do - to ask Mr. Landis if he wouldn't like to come over to the Board -?

HMjr: Yes

E: And state his views if he has any, with reference to the question of reserves?

HMjr: Yes -- that will be fine.

E: We did that before in regulation "U", you know, and I know he is interested in this and I think we'd like to get his view point.

HMjr: Yes. Well, I think that would be fine.

E: Well then, how would that - wouldn't that be the best way to handle that then?

HMjr: Well, when would that be?

E: Well, I -

HMjr: I mean, when are you going to have your Board meeting?

E: Well, we're going to have one this morning, but we won't - we'll wait until Broderick gets back before we discuss reserves.

HMjr: Well, I think, what I'll do - I mean, we're in no hurry here, see?

E: Yes

HMjr: And I don't want to crowd you. I mean, we can - whether we do anything this week or next week doesn't make any difference as far as the Treasury is concerned.

E: I'll be able to say to you tomorrow, if you have that meeting tomorrow, and I'm perfectly sure that I'll be able to make a definite commitment that the Board will not do anything except if done either prior to May fifteenth and if not we'll do nothing until after July.

HMjr: Yes

E: And we will definitely cooperate and we'll do nothing that will in any way embarrass the Treasury financing.

HMjr: You'll say that by tomorrow?

E: I can tell that to you in the morning. I could tell you now personally but I would like to ask the other fellows to say the same thing to me. I'm sure they will.

HMjr: Well then, you'd a little bit rather have a meeting tomorrow?

E: Well, I can give you that information tomorrow.

HMjr: Well then, let's have the meeting.

E: All right.

HMjr: Let's have the meeting.

E: I can give you that information definitely tomorrow.

HMjr: O. K. And then I won't change it, we'll leave the thing - now as I understand - Landis is coming over - will you invite him to come over to you?

E: We'll invite him to come over, oh, say Friday, but I mean we'll invite him before we do anything.

HMjr: Oh - well, I gather from your conversation you'd kind of like to meet with the Treasury tomorrow, is that right?

E: Well, that's - Harrison is here, isn't he?

HMjr: He'll come, yes.

E: Yes, - and- and if you want to meet tomorrow, now it's up to you entirely.

HMjr: That's all right - the time is set - I've set the time aside. We'll leave it for tomorrow.

E: Yes, all right, then. Eleven o'clock?

HMjr: Right -

E: All right.

HMjr: Thank you.

E: All right.

April 21, 1938

At the 9:30 meeting this morning, Bell took up the question of padding subscriptions to the Treasury offerings and said it was his idea to write a letter to each of the Federal Reserve Banks and ask them, in turn, to discuss it with the main banks and dealers within their district and invite the representatives of the Federal Reserve Banks to come in here about May 11 to discuss the subject of padding the subscriptions. HM, Jr. agreed that it would be well to write such letters. It was understood that the men from the Reserve Banks who are invited will have positions comparable to that of Dr. Burgess in the New York Federal Reserve. (Sample copy is attached.)

Bell discussed with the Secretary and the group a copy of resolution of the American Red Cross which came in the usual routine manner addressed to the Secretary in his capacity of Chairman of the Board of Trustees, Endowment Fund, of the Red Cross. The resolution recommended investment of Red Cross funds in Great Northern Convertible 4's, but it must be with the approval of the Secretary of the Treasury. HM, Jr. said his advice to the Red Cross was to invest only in Government bonds and if they insisted on investing their funds in other than Government securities, he will not approve and if the Red Cross insists, he would rather sever his connection as Chairman of the Board, because for the extra half-cent increased return, he feels the risk is not comparable to such a profit. He asked Bell to write a letter for his signature setting forth the principles as outlined by him. (Copy is attached.)

Mr. Bell also brought up the question of the ruling of the Securities Exchange Commission with respect to individuals who sell Governments being subject to "over the counter" regulations and the effect of this ruling on the arrangement being made with the Federal Reserve Banks to sell Baby Bonds. HM, Jr. said that he had already discussed the ruling and was having Oliphant write a letter to the Securities Exchange protesting against the very thing that Bell had brought up. (Copy of Oliphant's letter is attached.)

Another matter brought up by Bell was the financial statement of the Commercial Standard Insurance Company of Fort Worth, Texas. He reported that an examination of this statement revealed that it would be necessary for the concern to strengthen its financial condition prior to

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June 30, otherwise its certificate would not be renewed by the Treasury. HM, Jr's comment was that it was the first time such a case had been brought to his attention and it was explained that they were usually routine matters, but the reason this particular case was mentioned was because if the Treasury disapproved, there would be political pressure brought to bear on the Treasury. HM, Jr. said to write them a letter and tell them to "clean house."

COPY

April 17, 1936

Dear Mr. Landis:

My attention has been directed to S. 4023, containing proposed amendments to the Securities Exchange Act with particular reference to unlisted and over-the-counter transactions.

A comparison of the proposed amendments to subsections 15(a) and 15(c) reveals that no exception is made in the latter subsection covering exempted securities. I recognize the possible purpose of drawing a distinction between these two subsections. Nevertheless, the matter is of some concern to this Department in view of the potential conflict between regulations or practices of the Treasury relating to Government securities and any regulations that might be promulgated by the Commission pursuant to the amended subsection 15(c).

For this reason, I should appreciate receiving any comments you may care to express as to the possibility of inserting in the parenthetical phrase in subsection 15(c) an additional exception covering "exempted securities."

Very truly yours,

/s/ Wayne C. Taylor

Acting Secretary of the Treasury.

Hon. James M. Landis  
Chairman,  
Securities and Exchange Commission,  
Washington, D. C.

CVO:es  
4/14/36

April 27, 1936.

My dear Sir:

I think a full discussion between representatives of the Federal Reserve banks and the Department regarding the handling of subscriptions to Government issues will be helpful to the Treasury in its effort to control the unfair practices inherent in "padding".

Accordingly, I am requesting that you and the President of each other Federal Reserve bank send a representative to meet at the Department in the conference room (No. 81) at 10 o'clock on May 12, 1936. I believe it desirable that each bank's representative be an officer who is familiar with the problems encountered in marketing new issues, and who may authoritatively represent the bank in matters of policy. I am asking Dr. W. Randolph Burgess, Vice President of the Federal Reserve Bank of New York, to take charge of the meeting. Will you please wire me the name of the official who will represent your bank?

Among the questions which will be considered are the following:

1. Increase of deposit with application on customers' subscriptions.
2. Requirement that in all cases customers' deposits be paid to the Federal Reserve banks, through War Loan Deposit Account, or otherwise.
3. Limitation of subscriptions from banks and trust companies for their own account.
4. Inclusion of savings banks and private banks, as well as incorporated banks and trust companies, in any provision for control of subscriptions for their own account.
5. Reduction of the amount up to which preferential allotment will be given.
6. Control of dealers' subscriptions.
7. Requirement that only one subscription be entered by each subscriber, and in the district of his principal office, and that if, nevertheless, more than one subscription is entered, that the several subscriptions be treated as one.
8. Form of certification on application (subscription) form.

In addition to these questions, primarily affecting the Department's control of subscriptions, doubtless other problems will be discussed, including purchase and sale of allotments, loans by banks to customers for advance deposits and subsequent subscription payments, and subscriptions of stock exchange houses.

All these subjects, and any others which may occur to you, should receive consideration in advance of the meeting. In such connection, if you consider it advisable, you may wish to discuss these problems discreetly with representative bankers and dealers in your district, obtaining their views as to the proper control of subscriptions to insure uniform treatment and so far as possible to remove any element of unfairness in making allotments.

Very truly yours,

(Signed) Wayne C. Taylor

Acting Secretary of the Treasury.

R. A. Young, Esq.,  
President, Federal Reserve Bank,  
Boston, Massachusetts.

*Identical letter to all FRB except New York*

Similar letter sent to each  
FRB except New York, ~~XXXXXXXX~~

April 27, 1936.

My dear Mr. Harrison:

I think a full discussion between representatives of the Federal Reserve banks and the Department regarding the handling of subscriptions to Government issues will be helpful to the Treasury in its effort to control the unfair practices inherent in "padding".

Accordingly, I am requesting that the President of each Federal Reserve bank send a representative to meet at the Treasury on Tuesday, May 12, and, in such connection, I am enclosing a copy of an identical letter sent each President except yourself, the reason for the exception being that the matter has been discussed with Dr. Burgess of your bank, and, with your consent, which I am assuming, I wish him to take charge of the meeting.

Very truly yours,

(Signed) H. Morgenthau, Jr.

Secretary of the Treasury.

G. L. Harrison, Esq.,  
President, Federal Reserve Bank,  
New York, New York.

Enclosure

WEB:M 4-24-36

The Secretary

Mr. Taylor

I am enclosing a draft of a letter to Mr. Simons of the American Red Cross. I have been thinking this situation over and I have asked Oppen to prepare a memorandum outlining the legal aspects, of which I enclose a copy.

You will notice that your serving on the Board of Trustees of the Endowment Fund is prescribed by Congress and that it will not be possible for you to resign from this Board as long as you are Secretary of the Treasury. The alternative would be to have you and the other Treasury representatives vote against any recommendations other than the purchase of Governments on each occasion as it arises. Even if this were done the other trustees can out-vote the Treasury representatives and would probably do so. It had occurred to me that your action could also be misinterpreted to mean that you were so interested in maintaining a market for government obligations that you were over-stepping the original intention of Congress in setting up the Board of Trustees of the Endowment Fund as well as indirectly criticizing many State laws covering the investment of trust funds.

I haven't any suggestion to make to you in this matter, but I feel that I should call these aspects of the situation to your attention before you sign the letter which I have prepared or any similar communication.

I am withholding my own vote on a letter dated April 23rd covering investment in Great Northern Convertible 4's until you have expressed your desires in this matter.

Enclosure

(Actually signed 5/29/36)

Mr. Howard J. Simons,  
Secretary, Board of Trustees,  
Endowment Fund,  
American National Red Cross,  
Washington, D. C.

Dear Mr. Simons:

I am returning herewith copy of resolution of the Board of Trustees of the American National Red Cross Endowment Fund, which was enclosed with your letter of April 9, 1936, having indicated thereon my disapproval of the purchase of 125M Pacific Gas and Electric 3 3/4% bonds of 1961 and 250M Southern California Edison 3 3/4% of 1960 and my approval of the purchase of 45M U. S. Treasury 2 7/8%'s for 1960-55. I have retained a copy of the resolution for my files.

In recent months I have been giving considerable thought to the subject of trust funds and I have come to the conclusion that safety of principal is such a completely determining factor in connection with trust fund management that I feel I cannot indicate my approval for the purchase of any securities other than the direct obligations of the United States Government. I realize that this decision on my part may present complications for the Board of Trustees of the National Red Cross Endowment Fund, but I feel so strongly on this point that I cannot take any action other than that

Mr. Howard J. Simons

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indicated in my disapproval of the purchase of Pacific Gas and Electric and Southern California Edison bonds.

Very truly yours,

H. Morgenthau, Jr.,  
Chairman, Board of Trustees,  
Endowment Fund,  
American National Red Cross.

Enclosure

This memorandum was discussed with HM, Jr. at his home the evening of April 21, 1936.

The tax bill as reported by the Ways and Means Committee of the House is estimated by the Treasury to yield additional revenue as follows:

- (a) net continuing revenue of \$623,000,000 per annum from the tax on corporate earnings, and
- (b) net temporary revenue of \$180,000,000 from the windfall tax and temporary extension of the capital stock tax.

In consequence, this bill would fully provide the \$620,000,000 needed to take care of the permanent agriculture program and the annual financing of the payment of the soldiers bonus. It <sup>would</sup> fully provided for the first year of a three year period for recouping the ~~loss of~~ \$517,000,000 of processing taxes lost during the fiscal year 1936.

The ~~estimate~~ estimate of a yield of \$623,000,000 from the tax on corporate earnings assumes that such tax has become fully operative. During the first year, there would be, of course, some lag in the collection of this tax as, in the absence of special provision, there usually is whenever taxes are shifted from one base to another. I am informed that, as the bill will come to you from the House, it will contain a special provision eliminating substantially all of this lag, ~~in revenue from this tax during the first year.~~

about April 21 '36

THE REVENUE BILL OF 1936

APRIL 21, 1936.—Committed to the Committee of the Whole House on the state of the Union and ordered to be printed

Mr. DOUGHTON, from the Committee on Ways and Means, submitted the following

REPORT

[To accompany H. R. 12395]

The Committee on Ways and Means, to whom was referred the bill (H. R. 12395) to provide revenue, equalize taxation, and for other purposes, report it back to the House without amendment and recommend that the bill do pass.

The need for such a bill was called to the attention of the Congress by the President of the United States in his message dated March 3, 1936, which is quoted in full below:

*To the Congress of the United States:*

On January 3, 1936, in my annual Budget message to the Congress, I pointed out that without the item for relief the Budget was in balance. Since that time an important item of revenue has been eliminated through a decision of the Supreme Court, and an additional annual charge has been placed on the Treasury through the enactment of the Adjusted Compensation Payment Act.

I said in my Budget message:

"\* \* \* the many legislative acts creating the machinery for recovery were all predicated on two interdependent beliefs. First, the measures would immediately cause a great increase in the annual expenditures of the Government—many of these expenditures, however, in the form of loans which would ultimately return to the Treasury. Second, as a result of the simultaneous attack on the many fronts I have indicated, the receipts of the Government would rise definitely and sharply during the following few years, while greatly increased expenditure for the purposes stated, coupled with rising values and the stopping of losses, would, over a period of years, diminish the need for work relief and thereby reduce Federal expenditures. The increase in revenues would ultimately meet and pass the declining cost of relief.

"This policy adopted in the spring of 1933 has been confirmed in actual practice by the Treasury figures of 1934, of 1935, and by the estimates for the fiscal years of 1936 and 1937.

"There is today no doubt of the fundamental soundness of the policy of 1933. If we proceed along the path we have followed and with the results attained up to the present time we shall continue our successful progress during the coming years."

If we are to maintain this pleasant and sound policy, it is incumbent upon us to make good to the Federal Treasury both the loss of revenue caused by the Supreme Court decision and the increase in expenses caused by the Adjusted Compensation Payment Act. I emphasize that adherence to consistent policy calls for such action.

To be specific: The Supreme Court decision adversely affected the Budget in an amount of \$1,017,000,000 during the fiscal year 1936 and the fiscal year 1937. This figure is arrived at as follows:

Deficit to date (expenditures chargeable to processing taxes less processing taxes collected) in excess of that contemplated in the 1937 Budget	\$281,000,000
Estimated expenditures to be made from supplemental appropriation approved in the Supplemental Appropriation Act, 1936	296,000,000
Estimated expenditures to be made under the Soil Conservation and Domestic Allotment Act	440,000,000
Total additional deficit 1936 and 1937, due to Supreme Court decision and adjusted farm program	1,017,000,000

For the purposes of clarity, I divide the present total additional revenue needs of the Government into the permanent and the temporary ones.

Permanent Treasury income of \$500,000,000 is required to offset expenditures which will be made annually as a result of the Soil Conservation and Domestic Allotment Act recently enacted by the Congress and approved by me; and an additional sum recurring annually for 9 years will be required to amortize the total cost of the Adjusted Compensation Payment Act.

The net effect of paying the veterans' bonus in 1936, instead of 1945, is to add an annual charge of \$120,000,000 to the \$160,000,000 already in the Budget.

We are called upon, therefore, to raise by some form of permanent taxation an annual amount of \$620,000,000. It may be said, truthfully and correctly, that \$500,000,000 of this amount represents substitute taxes in place of the old processing taxes, and that only \$120,000,000 represents new taxes not hitherto levied.

I leave, of course, to the discretion of the Congress the formulation of the appropriate taxes for the needed permanent revenue. I invite your attention, however, to a form of tax which would accomplish an important tax reform, remove two major inequalities in our tax system, and stop "leaks" in present surtaxes.

Extended study of methods of improving present taxes on income from business warrants the consideration of changes to provide a fairer distribution of the tax load among all the beneficial owners of business profits whether derived from unincorporated enterprises or from incorporated businesses and whether distributed to the real owners as earned or withheld from them. The existing difference between corporate taxes and those imposed on owners of unincorporated businesses renders incorporation of small businesses difficult or impossible.

The accumulation of surplus in corporations controlled by taxpayers with large incomes is encouraged by the present freedom of undistributed corporate income from surtaxes. Since stockholders are the beneficial owners of both distributed and undistributed corporate income, the aim, as a matter of fundamental equity, should be to seek equality of tax burden on all corporate income whether distributed or withheld from the beneficial owners. As the law now stands our corporate taxes dip too deeply into the shares of corporate earnings going to stockholders who need the disbursement of dividends, while the shares of stockholders who can afford to leave earnings undistributed escape current surtaxes altogether.

This method of evading existing surtaxes constitutes a problem as old as the income-tax law itself. Repeated attempts by the Congress to prevent this form of evasion has not been successful. The evil has been a growing one. It has now reached disturbing proportions from the standpoint of the inequality it represents and of its serious effect on the Federal revenue. Thus the Treasury estimates that, during the calendar year 1936, over 4½ billion dollars of corporate income will be withheld from stockholders. If this undistributed income were distributed, it would be added to the income of stockholders and there taxed as is other personal income. But, as matters now stand, it will be withheld from stockholders by those in control of these corporations. In one year alone, the Government will be deprived of revenues amounting to over \$1,300,000,000.

A proper tax on corporate income (including dividends from other corporations), which is not distributed as earned, would correct the serious twofold inequality in our taxes on business profits if accompanied by a repeal of the present corporate income tax, the capital-stock tax, the related excess-profits tax, and the present exemption of dividends from the normal tax on individual incomes. The rate on undistributed corporate income should be graduated and so fixed as to yield approximately the same revenue as would be yielded if corporate profits were distributed and taxed in the hands of stockholders.

Such a revision of our corporate taxes would effect great simplification in tax procedure, in corporate accounting, and in the understanding of the whole subject by the citizens of the Nation. It would constitute distinct progress in tax reform.

The Treasury Department will be glad to submit its estimates to the Congress showing that this simplification and removal of inequalities can, without unfairness, be put into practice so as to yield the full amount of \$620,000,000—the amount I have indicated above as being necessary.

Turning to the temporary revenue needs of the Government, there is the item of \$517,000,000, which affects principally the current fiscal year. This amount must in some way be restored to the Treasury, even though the process of restoration might be spread over 2 years or 3 years.

In this case also the formulation of taxes lies wholly in the discretion of the Congress. I venture, however, to call your attention to two suggestions.

The first relates to the taxation of what may well be termed a windfall received by certain taxpayers who shifted to others the burden of processing taxes which were impounded and returned to them or which otherwise have remained unpaid. In unequal position is that vast number of other taxpayers who did not resort to such court action and have paid their taxes to the Government. By far the greater part of the processing taxes was in the main either passed on to consumers or taken out of the price paid producers. The Congress recognized this fact last August and provided in section 21 (d) of the Agricultural Adjustment Act that, in the event of the invalidation of the processing taxes, only those processors who had borne the burden of these taxes should be permitted to receive refunds. The return of the impounded funds and failure to pay taxes that were passed on result in unjust enrichment, contrary to the spirit of that enactment. A tax on the beneficiaries unfairly enriched by the return or nonpayment of this Federal excise would take a major part of this windfall income for the benefit of the public. Much of this revenue would accrue to the Treasury during the fiscal years 1936 and 1937.

The other suggestion relates to a temporary tax to yield the portion of \$517,000,000 not covered by the windfall tax. Such a tax could be spread over 2 years or 3 years. An excise on the processing of certain agricultural products is worth considering. By increasing the number of commodities so taxed, by greatly lowering the rates of the old processing tax, and by spreading the tax over 2 or 3 years, only a relatively light burden would be imposed on the producers, consumers, or processors.

FRANKLIN D. ROOSEVELT.

THE WHITE HOUSE, March 3, 1936.

The President requests the Congress to raise 620 million dollars of additional revenue annually by some form of permanent taxation. He suggests some form of undistributed profits tax. Your committee recognizes the fact that the greatest defect in our present system of taxation lies in the fact that surtaxes on individuals are avoided by impounding income in corporate surpluses. Therefore, your committee proposes a plan of taxation which taxes a corporation on the net income, but which fixes the rate in accordance with the proportion of the net income undistributed.

The major purposes of the change in the method of taxing corporate incomes are (1) to prevent avoidance of surtax by individuals through the accumulation of income by corporations, (2) to remove serious inequities and inequalities between corporate, partnership, and individual forms of business organization, and (3) to remove the inequity as between large and small shareholders resulting from the present flat corporate rates.

It is well recognized that the corporate form of doing business enjoys certain advantages over individual and partnership businesses. The existing law creates purely artificial additional advantages in some cases and artificial disadvantages in others, depending upon the size of the enterprise and the character of its ownership. Individuals and partnerships cannot minimize their taxes by failure to distribute their business earnings. Corporations should not be permitted to withhold from the beneficial shareholders unneeded corporate income at the expense of the revenues of the United States and to the detriment of the shareholder. The bill proposes to remove many of these inequities by relieving from tax corporations which distribute all their net earnings annually as earned, and by taxing corporations accumulating their net income at a rate to compensate to a large extent for the amount of tax on the shareholders' income lost by reason of the failure to make a complete distribution. Adequate safeguards are provided in the bill to prevent unreasonable taxation of incomes in the case of corporations in distress or with inadequate earnings to take care of their immediate business needs. No attempt is made under the bill to tax past accumulations of surplus. The provisions of existing law allowing deductions from gross income in the case of depreciation, depletion, bad debts, business expenses, and similar allowances remain unchanged by the bill.

Some simplification of administration should ultimately result from the new plan. The credit for dividends in computing normal tax will disappear from the individual tax return. The capital stock tax and excess-profits tax will be eliminated after the first year. This will remove the burden required in the preparation and verification of capital stock tax returns, which will become more burdensome year by year in connection with adjustments made to declared capital stock values.

The plan proposed is estimated to produce an average of at least 620 million dollars in additional revenue annually when it comes into full operation.

The President also requests that additional revenue be secured in the next 3 years amounting to 517 million dollars. This would require temporary taxes bringing in about 173 million dollars per annum. Your committee is of the opinion that if additional revenue is provided which will bring in 173 million dollars during the fiscal year 1937, this will take care of the President's request until the next session of Congress, which can then act more intelligently in the light of the conditions then existing. Therefore, your committee recommends that the capital stock tax be continued for 1 year at one-half the rate provided in the Revenue Act of 1935, and that a "windfall" tax be enacted to put a special levy on the unjust enrichment resulting from the nonpayment of excise taxes to the Government, where, nevertheless, the amount of such taxes has been passed on, in whole or in part, to others. It is estimated that this procedure will result in additional revenue from the capital stock tax of 83 million dollars and from the "windfall" tax of 100 million dollars. This gives a total of additional revenue for the next fiscal year of 183 million dollars, an amount 10 million dollars in excess of that asked for by the President.

## CONTENTS OF THE BILL

Title I of the bill, as reported, is a restatement of the existing income-tax law, with the changes necessary to effectuate the imposition of a tax on corporations, the rate of which will depend on the ratio of the undistributed net income to the entire net income; or, stated in another way, on the ratio of dividends paid to the net income. Title II of the bill contains the necessary amendments in respect to the capital stock and excess-profits tax. Title III of the bill contains the tax on unjust enrichment, which has been sometimes designated as a windfall tax. Title IV of the bill contains provisions dealing with refunds under the Agricultural Adjustment Act and floor-stocks adjustment. The titles enumerated above will now be explained more specifically.

### TITLE I. INCOME TAX

This title contains the necessary provisions for the levying of an income tax. The title does not repeal the provisions of existing law as to past years, but applies only with respect to taxable years beginning after December 31, 1935.

The major change proposed in existing tax law is in connection with the method of taxing corporate income. Under existing law corporations pay a tax of 12½ percent on the first \$2,000 of net income; a tax of 13 percent on the amount of net income in excess of \$2,000 and not in excess of \$15,000; a tax of 14 percent on the amount of net income in excess of \$15,000 and not in excess of \$40,000; and a tax of 15 percent on net income in excess of \$40,000. Under this system a corporation may retain all its net income and the Government fails to receive the tax it should secure from the surtax on the stockholders of such corporations. It is true, that if the Government can prove a corporation is formed or availed of for the purpose of preventing the imposition of surtaxes upon its shareholders, a special surtax can be collected from the corporation under section 102 of the existing law. The difficulty of proving such purpose, however, has rendered section 102 more or less ineffective. Moreover, under existing law, a corporation secures an unfair advantage over a partnership whose members are obliged to include in their returns their pro rata share of the partnership profits whether distributed or not.

Sections 13, 14, 15, 16, and 17 of the bill propose an entirely new plan for taxing corporate incomes, which it is believed largely remedy the defects and inequities in our existing system.

In the first place, the tax rate applies to the adjusted net income. The adjusted net income is the net income less interest on certain obligations of the United States and Government corporations. The principal item in connection with this deductible interest is the interest derived from Liberty bonds.

The rate of tax which is applied to this adjusted net income may be determined by either one of two methods—both methods producing the same result.

#### FIRST METHOD

The first method contemplates deciding on a certain amount of the adjusted net income which shall be retained by the corporation, that is, passed to surplus. This amount is called the undistributed net

income, which is more accurately defined as the adjusted net income minus (1) dividends paid and (2) the tax. The rate of tax will depend on the ratio of the undistributed net income to the adjusted net income. The rates are determined under this method by the use of schedule I, II, or III of section 13. If the corporation has a net income of \$10,000 or less, schedule I is used. If the corporation has a net income of \$40,000 or more, schedule II is used. The rates in schedule I are substantially less than in schedule II in order to give some relief to the small corporations. If the corporation has a net income between \$10,000 and \$40,000, the rate of tax is determined under schedule III, or schedule II, according to which schedule gives the lesser tax. The purpose of schedule III is to bring about a proper transition between the low rates of schedule I and the higher rates of schedule II. Schedule III is very important to the corporations with a net income between \$10,000 and \$40,000. For instance, the rate of tax on a net income of \$10,000 with 10 percent retained in surplus is only 1 percent under schedule I. Under schedule II the rate on a like percentage retained is 4 percent. Without schedule III there would be an increase in tax of \$300 upon an increase of \$1 in income over \$10,000. This, of course, is corrected by schedule III. It is also interesting to observe that it is estimated that there will be 247,000 corporations in 1936 which will report net income. Out of this number it is estimated that 214,000 will have net income less than \$10,000.

Three examples will show how these schedules are applied:

*Example (1).*—A corporation has an adjusted net income of \$10,000. It has as yet declared no dividends but it decides that it wishes to retain \$3,000 net in surplus (in undistributed net income). The percentage of undistributed net income to adjusted net income is, therefore, 30 percent. In schedule I it will be observed that when the undistributed net income is 30 percent (as shown in column 1) the rate of tax will be 7.5 percent (as shown in column 2). Then the amount of the tax will be 7.5 percent of \$10,000, or \$750, and the balance of the adjusted net income (\$10,000 minus \$3,000 minus \$750) or \$6,250 must be paid in dividends.

*Example (2).*—A corporation has an adjusted net income of \$100,000. It has as yet declared no dividends, but it decides that it wishes to retain \$22,500 net in surplus (in undistributed net income). The percentage of undistributed net income to adjusted net income is, therefore, 22½ percent. Since the rate of 22½ percent does not appear in schedule II, it is necessary to apply the rule immediately following the table in that schedule. This rule states that if the percentage is more than 20 and less than 30 that the rate of tax will be 9, plus six-tenths of the amount by which the percentage which the undistributed net income is of the adjusted net income (22½ percent in this case) exceeds 20. Applying this rule the rate of tax will be 9 plus six-tenths of 2½, or 10.5 percent. Then the amount of the tax will be 10.5 percent of \$100,000, or \$10,500, and the balance of the adjusted net income (\$100,000 minus \$22,500 minus \$10,500) or \$67,000 must be paid in dividends.

*Example (3).*—A corporation has an adjusted net income of \$20,000. It has as yet declared no dividends, but it decides that it wishes to retain \$2,000 net in surplus (in undistributed net income). The percentage of undistributed net income to adjusted net income is,

therefore, 10 percent. In such a case the corporation computes a tax under schedule II and under schedule III and is subject to whichever tax is the lesser. The schedule II tax is readily determined from the rate table included in that schedule. The rate for an undistributed net income of 10 percent of the adjusted net income is 4 percent. Then the tax under schedule II is 4 percent of \$20,000, or \$800. Therefore the dividend credit is \$17,200. The tax is now computed under schedule III. A tax is first computed under schedule I on the whole \$20,000 of adjusted net income. With 10 percent retained the rate is 1 percent and the tax is \$200. To this tax is added a tax under schedule II computed on the amount by which the adjusted net income (\$20,000 in this case) exceeds \$10,000. This excess is \$10,000 and the rate under schedule II for a 10-percent retention is 4 percent. Then this added tax is \$400. The total tax under schedule III is, therefore, \$200 plus \$400, or \$600. But the tax under schedule II alone was \$800, therefore, the taxpayer will have his tax computed under schedule III since that tax is the lesser—\$600 as compared with \$800. The effect of taking the tax computed under schedule III is to permit the \$200 tax saving to be retained as surplus free of tax.

#### SECOND METHOD

It may often be more convenient to the taxpayer to determine the amount of his dividend credit first and then to compute his tax. This is the purpose of schedules I-A and II-A, which gives the same result as schedules I and II. One example would seem sufficient to demonstrate how schedules I-A and II-A are applied, since their application is similar to the application of schedules I and II.

*Example.*—A corporation has paid dividends of \$50,000 during its dividend year. Its adjusted net income is \$100,000. Its tax is computed under schedule II-A. From the table included in the schedule it is to be observed that when the dividend credit equals 50 percent of the adjusted net income, as in this case, the rate of tax shall be 17.5 percent. Then the tax is 17.5 percent of \$100,000, or \$17,500, and the undistributed net income is \$32,500.

#### DIVIDEND YEAR AND DIVIDEND CREDIT

In connection with the above computations, it is important to be informed as to the definitions of "dividend year" and "dividend credit." These definitions are contained in section 27 of the bill. The term "dividend year" in the case of calendar-year returns begins on March 15 of the taxable year and ends on March 14 following the close of the taxable year. In the case of fiscal-year returns, a similar period is provided for.

The term "dividend credit" means the amount of dividends paid during the dividend year corresponding to the taxable year.

#### DIVIDEND CARRY-OVER

It is also important to note that the dividend credit may include dividends paid in excess of the adjusted net income for the 2 prior taxable years. The rule for this carry-over is contained in section 27 (c). This dividend carry-over is perfectly fair and will protect

the current revenues. Without this provision the tendency would be to discourage quarterly dividends, since dividends paid in excess of adjusted net income would never be credited to the taxpayer if this carry-over was not permitted.

#### EFFECT OF NEW PLAN

This new plan of taxing corporate net income, in the opinion of your committee, will not prevent the retention of earnings sufficient to provide for legitimate corporate needs but will discourage accumulation for which there is no sound reason. Under the plan, a small corporation can accumulate approximately 40 percent of its net income without paying a greater tax than it pays under existing law. Even a large corporation can accumulate 30 percent of its net income without paying more tax than it does under existing law. If none of the earnings of a corporation with a net income of \$10,000 or less are paid out in dividends the tax rate will be 29½ percent, and if none of the earnings of a corporation with a net income of more than \$10,000 are paid out in dividends the tax rate will not exceed 42½ percent.

#### TAXATION OF DIVIDENDS

It is, of course, important to note that a corporation which pays out all its adjusted net income in dividends will pay no tax, while under existing law it is taxed from 12½ to 15 percent on its entire net income. In order to treat the dividend consistently, it is, of course, necessary to subject the stockholder to both normal and surtax on these dividends. This is the most important change in the new plan in respect to individuals since they are now subject only to surtax in the case of dividends received from domestic corporations. This change is brought about by omitting the dividend credit allowed by section 25 (a) of the Revenue Act of 1934, as amended. It is also obviously necessary to omit section 23 (p) of existing law, which permits a corporation to deduct from its income 90 percent of the amount of dividends received from a domestic corporation. Under the bill a corporation will include in its net income 100 percent of the dividends received from other corporations.

#### EXCEPTIONS FROM GENERAL PLAN

It has been recognized that in certain cases corporations cannot pay out dividends or that sound policy demands the nonpayment of dividends. Therefore, in certain cases, a flat rate of tax is imposed on corporate incomes, or parts thereof, in lieu of the undistributed profits tax proposed in the general case.

*Deficits.*—For example, section 14 of the bill provides that corporations with a deficit shall pay a tax of 22½ percent on the amount of earnings necessary to make up this deficit and only come under the new plan in respect to earnings in excess of this deficit, and in excess of the tax paid at the 22½-percent rate. This rule is more accurately stated in the section.

*Contracts not to pay dividends.*—In section 15 a similar treatment is accorded in respect to that part of corporate net income that cannot be paid out in dividends without violating a written contract in existence prior to March 3, 1936.

*Debts.*—In section 16 similar relief is given in case of certain debts which are in excess of the accumulated earnings and profits.

It is also provided that sections 14, 15, and 16 noted above shall not operate to increase the tax which would be payable without the application of such sections. A corporation, however, cannot use more than one of the relief provisions just cited but must use the one which will result in the smallest tax.

#### BANKS, RECEIVERSHIPS, AND INSURANCE COMPANIES

Banks and trust companies are not brought within the new plan, but pay a flat rate of tax of 15 percent on their net income and domestic corporations in receivership are treated in the same manner. This seems to be a wise public policy, since the surplus of banks must be built up for the protection of the depositors and because receiverships in the vast majority of cases cannot, of course, pay dividends. For similar reasons there is a flat tax of 15 percent on the net income of all insurance companies whether domestic or foreign.

#### NONRESIDENT ALIENS AND FOREIGN CORPORATIONS

It has also been necessary to recommend substantial changes in our present system of taxing nonresident aliens and foreign corporations. It appears obvious that an undistributed profits tax is not well adapted to taxing a foreign corporation with foreign shareholders in respect to its income from sources within the United States. In section 211, it is proposed that the tax on a nonresident alien engaged in a trade or business in the United States and not having an office or place of business therein, shall be at the rate of 10 percent on his gross income from interest, dividends, rents, wages, and salaries and other fixed and determinable income. This tax (in the usual case) is collected at the source by withholding as provided for in section 143. Such a nonresident will not be subject to the tax on capital gains, including gains from hedging transactions, as at present, it having been found impossible to effectually collect this latter tax. It is believed that this exemption from tax will result in additional revenue from the transfer taxes and from the income tax in the case of persons carrying on the brokerage business. In the case of a nonresident alien engaged in trade or business in the United States, or having an office or place of business therein, the same tax is levied on his net income from sources within the United States as is levied on an American citizen, except for the disallowance of certain personal exemptions and credits for dependents.

In the case of a foreign corporation engaged in trade or business within the United States or having an office or place of business therein, it is proposed to levy a tax at a flat rate of 22½ percent on the net income of such corporation derived from sources within the United States. The dividends of such foreign corporations are not taxable to the foreign shareholder unless 75 percent or more of its gross income is from sources within the United States, in which case they are taxable to the foreign shareholder to the extent that the dividends represent American income. In the case of a foreign corporation not engaged in trade or business within the United States

and not having an office or place of business therein, it is proposed to levy a flat rate of tax of 15 percent on the gross income of such corporation from interest, dividends, rents, salaries, wages, and other fixed and determinable income (not including capital gains). This tax is to be collected in the usual case by withholding at the source. A special provision is made in the case of foreign banks carrying on the banking business in the United States whereby they will pay a tax of 15 percent on their net income from the banking business and 22½ percent on their net income from other sources within the United States. In addition to the above provisions, nonresident alien individuals are given a credit of \$1,000 against income attributable to compensation for personal services. It is also provided that income of any kind shall be excluded from gross income to the extent required by any treaty obligation of the United States.

It is believed that the proposed revision of our system of taxing nonresident aliens and foreign corporations will be productive of substantial amounts of additional revenue, since it replaces a theoretical system impractical of administration in a great number of cases.

#### MISCELLANEOUS PROVISIONS

It may be well to note the more important of certain miscellaneous changes recommended in existing law.

Section 102 of existing law dealing with the surtax on corporations improperly accumulating surplus, has been revised so as to apply only to banks, insurance companies, foreign corporations, China Trade Act corporations, certain domestic corporations doing business in the possessions of the United States, and personal holding companies. Most corporations are taken care of under the new plan and it is only necessary to bring the above list under section 102 in order to prevent tax avoidance. Section 351 of existing law dealing with personal holding companies has been eliminated from the bill.

It is provided in section 115 (f) that stock dividends shall be subject to tax to the extent that such dividends constitute income to the shareholder within the meaning of the sixteenth amendment to the Constitution.

Section 115 (c) has been revised so as to permit the shareholders (other than corporations) of a corporation, which is completely liquidated within a 2-year period, to be taxed on the resulting gain under the provisions of section 117 (a). The last-mentioned section allows a taxpayer to take into account in computing net income only a certain portion of the gain, varying according to the length of time for which he has owned the stock. The present rule which requires a taxpayer in such a case to be taxed on 100 percent of the gain is preventing liquidation of many corporations. Thus, we are getting very little tax under the strict rule now provided. It is believed that the result of this modification in the method of taxing gains arising from complete liquidation will bring about a substantial increase in the revenue. In the opinion of your committee that change will result in about 40 million dollars in additional revenue.

Your committee has inserted a provision in section 27 of the bill to prevent the delay or avoidance of the undistributed profits tax by means of chains of holding companies. This provision considerably restricts the dividend credit in the case of dividends paid by a corpo-

ration, 80 percent or more of whose gross income is derived from dividends.

Your committee is of the opinion that corporations which are exempt from the income tax under existing law should not be subject to the proposed plan for taxing corporations. Corporations paying dividends to such corporations receive the same dividend credit as if such dividends were paid to persons not exempt from the income tax.

#### TITLE II. CAPITAL STOCK AND EXCESS-PROFITS TAXES

Your committee has reduced the rate of capital stock tax imposed by section 105 of the Revenue Act of 1935 from \$1.40 per thousand of the adjusted declared value to 70 cents per thousand for the capital stock tax year ending June 30, 1936. This tax is terminated as to all future years. The provisions of existing law giving corporations the right to declare a new value for capital stock tax purposes for the capital stock tax year ending June 30, 1936, are continued in force. The excess-profits tax imposed by section 106 of the Revenue Act of 1935 is terminated at the end of the first income tax taxable year of the taxpayer ending after June 30, 1936. Accordingly, corporations whose income tax taxable years are on a calendar year basis will be subject to the excess-profits tax for the calendar year 1936. Corporations whose income tax taxable years are on a fiscal year basis, which year ends after June 30, 1936, will be subject to the excess-profits tax for the first income tax taxable year ending after such date. The excess-profits tax will not apply to any income tax taxable year which ends after June 30, 1937. Since these taxes were not considered in the proposed estimate submitted by the President, their continuance in effect for one more year will produce additional revenue in the amount of \$3 million dollars.

#### TITLE III. TAX ON UNJUST ENRICHMENT

Title III imposes a special income tax on the unjust enrichment accruing to any person as a result of passing on to others the burden of Federal excise taxes. The tax is 80 percent of the income representing unjust enrichment.

The income on which the tax is based is as follows:

(1) Where the taxpayer is a person on whom a Federal excise was imposed but not paid, the net income from the sale of articles upon which the excise was not paid shall be computed. This income to the extent that it is attributable to shifting to his vendees or others the burden of the excise, and this amount is subject to the tax.

(2) Where the taxpayer is a person who bought articles at a price including the burden of the excise and resold them at a price also including the burden of the excise, there shall be computed the net income attributable to any reimbursement he receives from his vendor for the burden of the excise, and this amount (limited by the extent to which he shifted the burden of the excise to his customers) is subject to the tax.

The tax does not apply to any income from any transactions other than those involving either (a) articles subject to an excise imposed on the taxpayer and not paid by him, or (b) articles with respect to which, as a dealer, the taxpayer is doubly reimbursed for the excise

burden in the manner explained under (2) above. Likewise, there will be no offset against the unjust enrichment from those transactions for losses incurred in any other transactions or business. However, subsection (1) of section 501 provides that if this broad application is held invalid, the tax shall apply only to the portion of the taxpayer's total net income (from all transactions for the entire taxable year) attributable to the unjust enrichment income.

Subsections (b) and (c) of section 501 contain rules for computing net income from the particular category of transactions to which the tax applies, and subsections (d) to (h), inclusive, contain provisions governing the calculation of the extent to which the taxpayer shifted the burden of the excise to others. *Prima facie*, this is determined by comparing the "margin" in the transactions involved with the "average margin" for the 5 years preceding the effective date of the excise in question. These margins are computed by deducting costs of materials (or, when the article was purchased by the taxpayer, the price he paid) from the selling prices. Credit against the selling price will be given for any amount rebated to the purchaser on or before March 3, 1936, or under a bona-fide written contract entered into on or before that date, and also for professional fees and expenses of litigation incurred in preventing collection of the excise, not in excess of 10 percent of the excise. If facts are lacking to establish the taxpayer's average margin for any part of the pre-excite period, the average margin of representative concerns, similarly located and circumstanced, is to be used for such part of the period.

This *prima-facie* method for determining the shifting of the burden of the excise may be overcome by proof of the actual extent of the shift. This may include proof of changes in labor and other costs of production or in the character of the articles or materials. Shifting of the excise may be shown by proof of price or contract changes to reflect the initiation or termination or change in the rate of excise, billing of the excise as a separate item to any vendee, written statements by the taxpayer that his price included the excise, or contracts to rebate all or a part of the amount of the excise in the event of its invalidity or recovery; unless the taxpayer shows that these facts are not relevant to the transactions in question.

Subsection (i) defines the term "Federal excise tax." It includes not only the recent processing taxes, but any tax (or exaction denominated a tax) under any valid or invalid Federal statute, of a type which is capable of being shifted by the taxpayer to purchasers of articles or services.

Subsection (j) makes the provisions with respect to cases where excises are never paid equally applicable to cases where they are paid and refunded, unless the refund is made under one of the provisions of law requiring a showing that the taxpayer absorbed the burden of the excise.

Subsection (k) makes applicable to sales of services subject to an excise all the provisions with respect to sales of articles.

Section 502 provides against double taxation of the unjust enrichment income by means of a credit against the tax under title III of the amount by which the regular Federal income and excess-profits taxes of the taxpayer would be diminished by excluding the amount of unjust enrichment from the computation of those taxes. Thus, in

effect, the total tax on the unjust enrichment is only the 80 percent provided for in this title.

Section 503 relates to administrative provisions.

Section 504 makes the tax applicable to any taxable year ending with January 1935 or at any time thereafter. The tax is thus sufficiently retroactive to cover the unjust enrichment accruing as a result of the impoundment and nonpayment of processing taxes during 1935.

Section 505 makes the title applicable to Puerto Rico and the Philippines, since the processing taxes were extended to those possessions.

#### TITLE IV. REFUNDS UNDER AGRICULTURAL ADJUSTMENT ACT AND FLOOR STOCKS ADJUSTMENT

It is the purpose of section 601 of this title to reenact into law certain sections of the Agricultural Adjustment Act, as amended, providing for refunds in certain cases. Section 601 (a) reenacts these sections for the sole purpose of allowing refunds in accordance therewith in cases where the delivery for charitable distribution or use, or the exportation, or the manufacture of large cotton bags, or the decrease in the rate of the processing tax (or its equivalent under section 16 (e) (3)), occurred prior to January 6, 1936. The enactment of this section will serve to remove doubts as to the legal authority of the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, which have existed since the decision of the United States Supreme Court holding the Agricultural Adjustment Act invalid, to continue the making of refunds under the provisions of sections 10 (d), 15 (a), 15 (c), 16 (e) (1), 16 (e) (3), and 17 (a) of that act, as amended.

Section 10 (d), is merely a general provision authorizing the Secretary of the Treasury to make necessary regulations to carry out the powers vested in him by the title of the Agricultural Adjustment Act.

Section 15 (a) provides for the suspension by the Secretary of Agriculture and the refunding or crediting of the processing or compensating tax upon such amount of a commodity as the Secretary of Agriculture should by proclamation find is used in the manufacture of any class of products of such commodity which is of such low value, considering the quantity of the commodity used for their manufacture, that the imposition of the processing tax would prevent in whole or large part the use of the commodity in such manufacture, thereby substantially reducing consumption and increasing the surplus of the commodity.

Section 15 (c) provides for the refunding or crediting to persons delivering any product to any organization for charitable distribution, or use, including any State or Federal welfare organization, for its own use, of any tax due or paid under the Agricultural Adjustment Act, with respect to the product so delivered, subject to certain prescribed conditions.

Section 16 (a) (1) makes provision for refunds or credits on floor stocks when the rate of the tax on the processing of any commodity generally or for any designated use or uses, or as to any designated product or products thereof for any designated use or uses, is decreased in the manner provided by the act. Section 16 (e) (3) makes section 16 (e) (1) applicable when the tax is suspended under section 15 (a).

Section 17 (a) makes provision for the refunding or crediting of processing taxes due and paid or due and payable on products processed wholly or partly from a commodity with respect to which product or commodity a tax has been paid or is payable, upon the exportation of such product or commodity to any foreign country or to the Philippine Islands, Virgin Islands, American Samoa, the Canal Zone, or the Island of Guam.

Section 601 (b) excludes from the benefits of the section the processor or other person who paid the tax with respect to the articles on which the claim is based, for the reason that the claims of such persons are within the provisions of section 21 (d) of the Agricultural Adjustment Act, as amended.

Section 601 (c) requires the filing of claims under the section prior to January 1, 1937, under rules and regulations prescribed by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury and limits the allowance of claims to those in an amount of \$10 or more, the cost of administering claims of less than \$10 being disproportionate to the amount involved from the point of view of both claimants and the Government. Sections 16 (g) and 21 (f) of the Agricultural Adjustment Act, as amended, which it is proposed to repeal, contain time limitations upon the filing of claims inconsistent with the provisions of section 601 (c).

Section 601 (d) is similar to the provisions of existing law relating to internal-revenue taxes which limit administrative review of the findings of fact and the decision of the Commissioner of Internal Revenue upon the merits of claims adjusted pursuant to this section to cases of fraud or mistake in mathematical calculation.

Section 601 (e) makes the determination of the Commissioner of Internal Revenue with respect to any refund under this section final and not subject to judicial review, and section 601 (f) disallows any claim for interest with respect to claims for refund made under this section. It is the opinion of your committee that, while provision for the relief of claimants in the cases covered by this section should be made, the fact that the refunds will be made to persons other than those who paid or were liable for payment of the tax under the Agricultural Adjustment Act, as amended, and the present doubt as to the legal status of these claims warrants the disallowance of interest and the withdrawal of any right to judicial review of the determinations of the Commissioner.

Section 601 (g) is intended to correct an inadvertent error in the language of section 16 (e) (1) of the Agricultural Adjustment Act, as amended, as the result of which the date "June 26, 1934" was inserted in lieu of "June 1, 1934", which latter date the legislative history of the amendment clearly indicates was the date intended. The result of this error was to prevent the payment by the Secretary of the Treasury of a number of claims on floor stocks which had been examined and allowed, based upon the certification by the Secretary of Agriculture under date of June 12, 1934, that the processing tax on large cotton bags had been removed. It is the opinion of your committee that the impediment to the payment of these meritorious claims created by this legislative error should be removed.

## SECTION 602. FLOOR STOCKS AS OF JANUARY 6, 1936

It is the recommendation of your committee that this section should be enacted into law, as a matter of fair dealing and sound public policy. Its effect will be to place all holders of floor stocks on January 6, 1936, of articles processed wholly or in chief value from commodities subject to the processing tax on that date, except the processor or other person who paid or was liable for the tax, in substantially the same position they would have occupied had the processing taxes been terminated by proclamation by the Secretary of Agriculture in the manner provided by the Agricultural Adjustment Act.

The Agricultural Adjustment Act provided for a floor-stocks tax on the effective date of the processing tax in order that all articles, the product of a commodity subject to the processing tax, should move into the channels of trade equally taxed. That act likewise provided, with certain limitations, for a refund upon termination of the tax to holders of floor stocks so that, in the main, articles on hand on that date and articles subsequently processed would also move into the channels of trade, this time equally untaxed. Certain inequities have resulted from the termination of the processing taxes which it is the purpose and effect of this section to remove.

Section 602 (a) excludes from the benefits of the section holders of floor stocks who were also processors or other persons who paid or were liable for the tax, for the reason that their rights to refund are governed by section 21 (d) of the Agricultural Adjustment Act, as amended.

Section 602 (b) provides the method of computation of the amount of refund to which a person entitled to claim under section 602 (a) may recover, viz, an amount equal to the processing tax which would have been payable with respect to the commodity from which the article or articles held in floor stock were processed, had the processing occurred on January 5, 1936. It is further provided, however, that this amount shall not exceed the amount of the burden of the tax with respect to the article or articles which was shifted to the claimant in the price he paid for the article, diminished by the amount the claimant has received or will receive by way of reimbursement for such burden from his vendor; also that the amount refundable shall not exceed the amount by which the claimant reduced the sale price of the article or articles on account of the invalidation of the processing taxes. The term "sale price" as here used is intended to include the price at which the claimant actually sold the article or articles prior to the date of the filing of his claim or, if the article or articles have not been sold, the price at which he is offering the same for sale.

Section 602 (c) (1) and (2) contain clarifying definitions of certain terms used in the section.

Section 602 (d) requires all claims under the section to be filed prior to January 1, 1937, in conformity with regulations prescribed by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury and requires every claimant to establish to the satisfaction of the Commissioner the facts on which his claim is based.

Section 602 (e) relieves claimants of any necessity of proving that any processing tax has been paid with respect to the article or articles on which their claims for refund are based. It is the opinion of your committee that this provision is justified and that any advantage which might otherwise result to the processor or other person liable for the tax but who did not pay the same will be largely eliminated by the tax on unjust enrichment under title III. The limitation on allowance of claims to those of \$10 or more is recommended for the reason that the cost of administering claims of lesser amount is disproportionate to the sum involved.

The limitations on floor-stocks refunds contained in section 602 (f) correspond to those contained in section 16 of the Agricultural Adjustment Act, as amended, relating to refunds on floor stocks and are based largely upon considerations of administrative convenience.

Section 602 (g) is intended to cover cases of articles, agreed to be sold under contracts entered into prior to January 6, 1934, but not delivered prior to such date, wherein the vendee agreed to pay a price which included the tax. In such cases the vendee is treated as the holder of such articles for the purposes of this section.

Section 602 (h) is similar to the provisions of existing law relating to internal-revenue taxes which limit administrative review of the findings of fact and the decision of the Commissioner of Internal Revenue upon the merits of claims adjusted pursuant to this section to cases of fraud or mistake in mathematical calculation.

Section 602 (i) makes the determination of the Commissioner with respect to any payment under this section final and not subject to judicial review. Section 602 (j) denies any allowance of interest in connection with payments made under this section. Since the section is purely remedial and provides a form of relief which, however, justifiable as a matter of equity and sound policy, is not required by law, your committee is of the opinion that both provisions are warranted by considerations of administrative convenience and economy and the prevention of unnecessary litigation.

## VIEWS OF THE MINORITY

We, the Republican members of the Ways and Means Committee, are opposed to the enactment of this bill. Our basis of opposition is twofold:

1. We do not favor the imposition of any new taxes until the waste of public moneys is stopped.

2. The proposed bill is unsound in principle, will undermine business stability, and is another step toward the regimentation of all business. It is not designed to raise revenue, but is admittedly another New Deal experiment.

We have had no opportunity to examine the 236-page bill before today. We have not been permitted a part in drafting it. It was prepared by the Democratic majority behind closed doors from which we were excluded. They must assume full responsibility for it. We are certain that they were "whipped" into acceptance, against their better judgment, of proposals advocated by no one of experience or ability in the field of taxation.

### I. INCREASED TAXES VERSUS REDUCED EXPENDITURES

In our minority views filed in connection with the President's so-called share-the-wealth tax measure of last year, we said:

In opposing this bill, we are not taking a stand inconsistent with our previously expressed attitude in favor of a balanced Budget, which we still favor, but it should be balanced by reducing expenditures and not wholly by increasing taxes. The administration has no right to increase the tax burden on either rich or poor until it has first adopted a sane spending program.

Feeling that the necessity for applying this sound principle is even greater today than it was when these views were expressed, we take the same position with respect to the pending bill.

We recognize fully the vital necessity of putting the Government on a pay-as-you-go basis, but do not for one moment concede that serious attempt toward that end is made through the medium of this bill. As a face-saving, penitent gesture at Budget-balancing, the bill is as much a farce as was the President's so-called "share-the-wealth" measure of last session. It is idle for the administration to claim that the "ordinary" Budget will be balanced if the bill is enacted into law. Budget Director Bell is himself authority for the statement that we have only one Budget, which includes both "ordinary" and "extraordinary" expenditures. The Budget—the only one we have—is actually several billions of dollars out of balance.

HUNDREDS OF MILLIONS BEING SPENT UNNECESSARILY, WASTEFULLY,  
EXTRAVAGANTLY, AND POLITICALLY

It should not be overlooked that there are two sides to a budget—the revenue side and the expenditure side. There can be no question but what the administration is now spending hundreds of millions of

dollars unnecessarily, wastefully, extravagantly, and politically, without any thought of securing value received for the taxpayers' money. Some 43 enthusiastic governmental agencies have a hand in the disbursement of emergency funds. Moreover, under the whip and spur of Postmaster General Farley, acting in his other capacity of Chairman of the Democratic National Committee, practically every bureau and department continues to add the "party faithful" to the public pay roll regardless of need or expense. Instances have been cited where practically half the money appropriated for relief purposes goes to pay the salaries of political appointees and thus never reaches the needy persons for whom it was intended.

**NO NEW TAXES SHOULD BE IMPOSED UNTIL EXPENSES ARE REDUCED TO REASONABLE MINIMUM**

If Government spending were placed upon a prudent and economical basis, there is reason to believe that existing taxes might be sufficient to carry the cost of government without curtailing essential functions or abandoning necessary relief. However, when and if governmental expenditures have been reduced to a reasonable minimum, additional taxes still are needed, we will be glad to cooperate in a thorough revision of the tax structure all along the line in order to raise sufficient revenue to maintain the Nation's solvency, and we believe that the taxpayers of the country would willingly, under those conditions, shoulder any necessary increase in the tax burden for that purpose. Until that is done we are opposed to the imposition of any new tax burden on business or the people.

**IMPROVED CONDITIONS WOULD RESULT IN INCREASED YIELD FROM EXISTING TAXES**

Attention is called to the fact that since 1933 tax collections have increased as follows:

1933.....	\$1,620,000,000
1934.....	2,672,000,000
1935.....	3,299,000,000
1936 (estimated).....	3,875,000,000
1937 (estimated).....	5,140,000,000

Most of this increase of revenue has, of course, been due to the imposition of new taxes. It should be borne in mind that as and if conditions improve, collections from the taxes now in effect will correspondingly increase. At the same time, as a result of improvement of conditions, there would be less demand upon the Federal Treasury for recovery and relief funds.

Most of the improvement to date has resulted in spite of the impediments and constant administration harrassments which have confronted business at every turn. The progress of recovery has been particularly marked since the Supreme Court's invalidation of the National Recovery Act. The proposal to take several hundred millions additional from the people at this time by the methods provided in the bill is a definite interruption of the "breathing spell" which the President promised the country last fall. It constitutes not only a new impediment to recovery but also presents a definite threat to the stability of business and employment.

**A DOLLAR OF EXPENDITURE SAVED MEANS A DOLLAR OF NEW TAXES AVOIDED**

In opposing this bill, we are actuated by the thought that every dollar of wasteful expenditure saved means a dollar of new taxes avoided. We, therefore, recommend that the amount of money proposed to be raised by the bill be realized by eliminating unnecessary, wasteful, and extravagant expenditures, thereby removing the threat to recovery which the bill carries with it and putting a stop to the utterly indefensible policy of continually imposing new taxes to fill the pockets of the administration's spendthrifts and boondogglers.

**II. PROPOSED TAX ON UNDISTRIBUTED CORPORATE EARNINGS**

The proposed scheme to tax the undistributed portion of a corporation's earnings, rather than total income, cannot be justified either as a revenue measure or as a desirable tax reform. Our objections to the plan, in general, may be summarized as follows:

**SUMMARY OF OBJECTIONS**

1. It will discourage and possibly prevent the accumulation of adequate rainy-day reserves and constitutes a direct threat to the security of business, employment, and investments.
2. It will cause corporations to restrict the distribution of their existing tax-paid reserves, which can only be rebuilt under penalty.
3. It will discourage business rehabilitation and expansion and have a retarding effect upon recovery and reemployment.
4. It will hamper the growth of small corporations, impede the development of new enterprises, and foster monopolies.
5. It puts a penalty on prudence and a bounty on improvidence and constitutes an unwholesome interference with the exercise of sound judgment in the management of business.
6. It will accentuate the extremes of future booms and depressions.
7. It will oppress businesses burdened with debts and will result in a restriction on corporate credit.
8. It will drive capital out of productive enterprise into tax-exempt securities.
9. It violates every sound principle of income taxation, is arbitrary and oppressive in its application, and will be unequal and discriminating in its operation.
10. It will crucify financially weak business enterprises, while permitting the strong to minimize or entirely escape the tax.
11. It will create inequities and unfair competitive situations which are far greater and more real than the imaginary ones it purports to correct.
12. It will result in the double taxation of all dividends paid out of reserves, whether accumulated in the past or in the future.
13. It will cause untold confusion and add bewildering complexities both in the computation and administration of the tax.
14. It abandons an assured revenue of \$1,100,000,000 annually for one purely speculative and uncertain, and which promises to be most disappointing in amount, thereby further jeopardizing the Federal revenue.

Many other objections could be cited, but the foregoing are deemed sufficient basis for a discussion of the proposed tax as contained in the bill.

#### PLAN IN ACCORD WITH TUGWELLIAN PHILOSOPHY AND HAS COMMUNIST APPROVAL

The fact that the moving spirit behind the proposed scheme appears to be Professor Oliphant, of the Treasury Department, whose knowledge of tax problems and business affairs has been gleaned only from books and the classroom, is nothing to commend it.

The fact that it is directly in line with Professor Tugwell's proposal to use the Federal taxing power as a means of forcing the distribution of corporate surpluses is at least ground for viewing it with suspicion.

And the fact that it was wholeheartedly endorsed during the hearings by the witness who appeared in behalf of the Communist Party is a striking indication of the fundamentals which underlie it.

Outside of Treasury officials, only three witnesses appeared before the committee in support of the proposed tax scheme. One was the above-mentioned Communist; one a young lawyer from New York, who had certain theories of his own regarding taxation; and the other a Government employee named Stock, masquerading as a private citizen, who had been invited to appear by the Treasury Department, and whose real identity as a Treasury lobbyist was only brought out on cross-examination.

#### PRACTICAL BUSINESSMEN OPPOSE PLAN

No other person appeared before the committee in favor of the proposed scheme. On the contrary, it was without exception opposed by every representative of business who testified, whether appearing for national groups or individual firms. This opposition was based wholly on the vicious character of the proposal, and not on any selfish effort to shift the burden of increased taxes to other groups.

Among those conspicuously absent were the really big business interests of the country who, by reason of their adequate existing surpluses, view the proposal with equanimity because it will relieve them of their present tax burden and at the same time crush their smaller competitors.

Also among those conspicuously absent from the hearing was the Secretary of the Treasury, Mr. Morgenthau. While the committee has not been particularly enlightened in the past by any testimony he has presented, it appears rather strange to the minority that for the first time within our knowledge during the consideration of a tax bill, a Secretary of the Treasury failed either to make a personal appearance or submit a statement in writing. The committee was thus denied the opportunity of learning what views Secretary Morgenthau, the Nation's chief finance officer, had with respect to the proposal.

#### SIMILAR SCHEMES HAVE BEEN REJECTED IN PAST

Proposals of one form or another to tax undistributed earnings have repeatedly been before Congress, but in each instance, after careful and thorough consideration, they have been rejected. Attention is directed to the fact that in 1927, the staff of the Joint Congress-

sional Committee on Taxation, headed by Mr. L. H. Parker, made a comprehensive study of the Federal income tax, and their report had this to say with respect to the taxation of undivided profits:

The most obvious objection to such a tax is the burden which it places on legitimate and proper business expansion. As a business expands not only does its plant and property increase but a larger working capital is required and it is desirable that reasonable accumulations of profits necessary for the expansion and stability of corporations should not be unduly burdened. \* \* \* It is believed that a tax on the total accumulation of profits by corporations is not desirable, because in many cases it might cause the making of unwise distributions and prevent the accumulation of reasonable and proper surplus.

Evidence was presented to the committee that less drastic plans to that proposed in the bill had been tried in certain foreign countries but had not worked well. This was particularly true of the Norwegian scheme.

#### COMMITTEE QUICK TO FIND OBJECTIONS TO PLAN

The present proposal, which in less vicious form has consistently been rejected in the past, and which has been repudiated in principle by Congress' own capable and respected tax advisor, is before Congress at this time only because it was suggested to the President by a group of impractical theorists and so-called reformers.

At the time the scheme was brought to the attention of Congress by the President, it was simply an undeveloped idea. Little thought, if any, had been given to how the plan would apply to particular cases.

As soon as the Ways and Means Subcommittee began to consider the proposal it became apparent that it would be economically dangerous in effect and harsh and arbitrary in its application and that certain exemptions and modifications would have to be made. First the rate structure was graduated; then banks and insurance companies were exempted from the plan; then it was found that the plan would be oppressive to corporations in receivership and those with debt-funding obligations. Treasury officials looked with disapproval upon each exemption or modification made because it meant a reduction in the estimated revenue, and finally the process of relieving the oppressive application of the proposal had to be stopped if there was to be any revenue left. Thus, in its present form, it is still unwise and unjust.

#### BILL ABOLISHES PRESENT CORPORATE TAXES YIELDING \$1,100,000,000 ANNUALLY

If the tax scheme proposed by the bill is enacted into law, all present corporate taxes, which now yield an estimated revenue of \$1,100,000,000, will be repealed. These include the corporation income tax of 12½ to 15 percent; the excess-profits tax; the capital-stock tax; and the special taxes on unreasonably accumulated surpluses (secs. 102 and 351 of the present law).

#### NEW TAX BASED ON UNDISTRIBUTED PORTION OF EARNINGS

Under the new scheme, corporations which distribute to their stockholders all income currently earned will pay no corporate taxes whatever. However, dividends received by shareholders, which

are now subject only to the surtax, will henceforth be subject to the normal tax as well. Where corporations retain any portion of their earnings, the proposed plan imposes a tax on their entire net income, graduated according to the percentage of net income retained.

#### NOT A TAX ON EARNINGS BUT A PENALTY ON RESERVES

It is apparent that the tax is in no sense a tax on corporate earnings, but a penalty on the accumulation of protective reserves, on business rehabilitation and expansion, and on the payment of debts. The amount of the penalty may be as much as 42½ percent of the net income, depending upon the proportion which the amount retained for these purposes bears to the total net income.

In penalizing reserves and exempting amounts distributed, the proposed scheme in effect punishes prudent business management and holds out a seductive invitation to improvident management. It thus constitutes an unwise and dangerous meddling in the determination of an organization's fiscal policy, making government policy instead of sound business judgment the controlling factor.

#### RESERVES CONSTITUTE "LIFE-INSURANCE POLICIES" OF BUSINESS

The dangerous and unwholesome effect of any tax which discourages or prevents the accumulation of protective reserves while offering a bounty for improvidence is, we think, so apparent as to require little if any discussion. Mr. Raymond Moley, editor of the magazine *Today* and former close adviser to the President, in condemning the proposal to penalize the accumulation of reserves, very properly characterized them as the "life-insurance policies of business firms." It may be said, also, that they are to a business what a savings account is to an individual. But they are even more: They constitute the most effective and the most liberal form of unemployment insurance yet devised, enabling employees to be kept on the job in spite of hard times and unforeseen contingencies. Likewise, they permit the continuity of dividends when they are most sorely needed.

If business is led to pay out all of its earnings during prosperous years, and is discouraged or prevented from building up reserves for "rainy days", the natural consequence will be that the peaks of future booms will be accentuated, and the valleys of future depressions deepened. Thus the proposed tax seems to run directly contrary to the administration's supposed policy of stabilizing business and providing social and economic security. It might be added that as a further consequence, the Federal revenues will likewise become more unstable.

#### EXPERIENCE DURING DEPRESSION DEMONSTRATED VALUE OF RESERVES

The experience which the country has had during the present depression has amply demonstrated the necessity and value of reserves and their importance as a stabilizing influence. It is not pleasant to contemplate how much worse the depression might have been had the scheme of taxation now proposed been in effect prior to 1929, and business had entered the depression either stripped of its reserves or

with only nominal amounts. Hardly a business would have been left standing; the army of the unemployed would have been more than doubled; the greater part of the population would have been forced on relief.

The reserves which they built up in the prosperous years were alone responsible for enabling thousands of organizations to continue in business during the depression, to provide jobs for millions of persons who otherwise would have been without work, and to maintain dividend payments. That, of course, is what reserves are for. Had more business firms pursued the wise and prudent policy of building up reserves in prosperous years to tide them over the lean years, the country would have been in a much better condition to meet the depression than it was.

#### THE CONTRIBUTION OF BUSINESS TO RECOVERY AND RELIEF

The Department of Commerce is authority for the statement that from 1930 to 1934, inclusive, business income paid out in the United States exceeded income produced by 26.6 billions of dollars. This tremendous sum in a sense represents the contribution made by business out of its reserves for recovery and relief, and it is to be noted that the amount is considerably in excess of that spent by the Federal Government for this purpose. It was thus fortunate for the country that the tax policy in effect during the prosperous years was not such as to penalize or prevent the accumulation of the business reserves out of which these billions have been paid.

#### EFFECT OF TAXES ON EXISTING RESERVES

We wish to call particular attention to the fact that the proposed tax will not only discourage the accumulation of reserves in the future, but it will also have the effect of discouraging corporations from making further drains on their existing reserves, whether for the maintenance of employment, wages, or dividends, or for rehabilitation or expansion, since they can be rebuilt in the future only under penalty. Thus, although the intended purpose of the bill is to force the distribution of earnings, it will have an exactly opposite effect so far as existing reserves are concerned.

#### TAX WILL RETARD BUSINESS EXPANSION

In penalizing the reinvestment or "plowing back" of current earnings for purposes of business expansion and rehabilitation, the proposed tax bill will have a blighting effect upon recovery. In his recent relief message, the President warned industry that it must either give employment to labor or else the Government would, but the tax he has proposed discourages business from doing that very thing. It is already difficult for business enterprises to secure bank loans for expansion purposes, and investors are unwilling to risk their capital due to uncertainty as to the future, a condition which the policies of the administration have done much to bring about. Hence, the only way business at present can obtain funds is by reinvestment of its earnings.

## GROWTH OF SMALL CORPORATIONS STIFLED

This penalty on earnings "plowed back" into the business will tend to stifle the growth of small corporations and will repress the development of new enterprises, since they have virtually no other means of obtaining new funds. By "freezing" small corporations at their present size, and by discouraging new competition, the tax will be conducive to monopoly. It will cause the small corporation to stay small, while allowing the large corporation to continue in its dominating position.

## WILL PENALIZE PAYMENT OF DEBTS AND CAUSE RESTRICTION ON CREDIT

By imposing an oppressive penalty on earnings used or set aside to repay debts, the tax not only makes it more difficult for businesses to meet their obligations, but tends to impair the value of the obligations themselves. It is indeed a strange philosophy underlying a tax bill which punishes honesty and integrity, and encourages dishonesty and irresponsibility.

The natural result of this policy will be an unfortunate and undesirable restriction on corporate credit, which is already at a minimum. Banks and other creditors will not only tighten up on existing loans, but will impose more strict conditions on new ones. This curtailment of credit will in turn result in a curtailment of business activity, thereby further hampering recovery and reemployment. It will have a particularly depressing effect upon the making of loans for purposes of business rehabilitation and expansion. Thus again we find the bill running at cross-purposes with other avowed policies of the administration.

## SCHEME VIOLATES ALL SOUND PRINCIPLES OF TAXATION

We have stated that the proposed tax violates every sound principle of income taxation and creates numerous inequities and unfair competitive situations. This is apparent from even the most cursory examination into its application to individual cases.

One of the most fundamental objections to the tax is that it falls hardest on the business with the least tax-paying ability, and thus violates a cardinal rule of taxation. The large, financially strong corporation having an adequate existing surplus will be able to avoid the tax entirely by distributing all of its current earnings, but the financially weak corporation, which must set aside all or a substantial part of its earnings to retire its outstanding debts or build up its capital structure, must pay excessive rates of taxation for the privilege of so doing. Thus the proposed scheme favors the strong as against the weak, and, in general, the large as against the small.

The bill violates another rule of income taxation when it taxes businesses with exactly the same income at rates varying from zero to 42½ percent. Similarly, it may tax a business with a small income at a high rate and one with a large income at a low rate.

## UNFAIR COMPETITIVE SITUATIONS CREATED

These unequal applications of the tax are not only unjust, but they give rise to unfair competitive situations as between different firms in the same line of business. The strong company may escape with no tax, while the weak competitor may be subject to a heavy burden which puts it at a disadvantage in competing for business. The latter might thus be led to follow an improvident financial policy in order to meet the prices of its rival, and in the end be forced out of business whichever way it turned.

## VARYING NEED FOR RESERVES

The graduated schedule of rates is based on the arbitrary and false assumption that what constitutes a reasonable reserve for one kind of corporation constitutes a reasonable reserve for another. This is absolutely contrary to fact. Some businesses have a steady and assured income, and therefore have need for only small reserves. Businesses in which the income is unsteady from year to year, due to risks and hazards or other causes, need very substantial reserves. Thus one kind of corporation is benefited because it does not need substantial reserves, and one is penalized because it does.

## RATES OPPRESSIVE

The oppressive character of the proposed rates of tax is undeniable. A corporation may be subjected to a rate of as much as 42½ percent upon its net income, as against 12½ to 15 percent under the existing law. This means that where a corporation desired or was obliged to retain all of its income for reserve, debt-paying, or expansion purposes, it would find that the most it could possibly retain would be 57½ percent because the tax would consume the balance.

Certain so-called "relief" provisions are contained in the bill which, under certain circumstances, permit a company to pay 22½ percent in lieu of the maximum rates, but even 22½ percent is from 50 to 80 percent higher than the present rates, and will not constitute much "relief" to the business which is forced to pay it. A little more of this character of "relief" would result in business paralysis and insolvency.

## SMALL SHAREHOLDER MAY BE PENALIZED

The President in his message to Congress contended that "the present corporate taxes dip too deeply into the shares of corporate earnings going to stockholders who need the disbursement of dividends", but under the scheme he has himself proposed, a small stockholder may have his proportionate share of the corporate earnings decreased by a tax of as much as 42½ percent before distribution, and then be subjected to the normal individual income-tax of 4 percent, plus the surtax, if any, on his share of the remaining 57½ percent when distributed.

It is amazing and refreshing to note the President's interest in the small stockholder after recalling his absolute insistence last year upon the passage of his graduated corporate income tax, which taxed the small stockholder in a large corporation at a higher rate than the large stockholder in a small corporation. This unsound measure, which we vigorously opposed, is now being abandoned by the President even before it has had a chance to go into operation, and there is reason for hoping that the vicious scheme now proposed may have a similar fate.

#### NO REAL DISCRIMINATION AT PRESENT BETWEEN CORPORATIONS AND PARTNERSHIPS

One of the reasons advanced for making the change in the method of corporate taxation here proposed is that the present system is discriminatory as between partnerships and corporations, in some cases in favor of one and in some cases in favor of the other. If any such discriminations exist, they are within the power of the owners of either the corporation or the partnership to remedy. There can be no justification, however, for creating a thousand and one new injustices and inequities for the purpose of adjusting one alleged inequity which is more apparent than real.

#### EVASION OF SURTAX ADEQUATELY PREVENTED BY PRESENT SYSTEM

Likewise, we do not see any justification for undermining the security of the whole business structure merely to prevent the evasion of surtaxes which are not to any great extent being evaded. The Treasury Department's own statistics show that in the 13-year period from 1921 to 1933, inclusive, corporations in the United States paid out \$50,700,000,000 in dividends as against a total net income of only \$41,000,000,000, which seems to negative any charge that corporations are unreasonably accumulating reserves so that their stockholders may avoid the payment of the surtax. Where corporations are formed or availed of for that purpose, sections 102 and 351 of the existing law are adequate to compel a distribution of any unreasonably accumulated surplus. Even if a few of the "guilty" escaped, it would be better to have this occur than to disrupt the stability of our whole business structure trying to catch them.

#### BILL WILL DRIVE CAPITAL INTO TAX-EXEMPT SECURITIES

The greatest opportunity for tax avoidance, however, lies in the field of tax-exempt securities, a field which the present administration continues to enlarge by billions of dollars each year. All State and local securities are completely exempt from Federal income tax, and approximately half of the securities issued by the National Government are completely exempt, while the remainder are exempt only from the normal tax. The scheme of taxation proposed by the pending bill, by imposing oppressive taxes and by impairing the financial security of business, will tend to drive capital from investment in productive enterprise, with its already great hazards, into the sheltered haven of safe and sound tax-exempts. Even aside from the relative risks involved, and considering only the rates of taxation now

imposed, a wealthy investor would find it much more advantageous to receive 3½ percent from tax-exempt bonds than 8 percent from a taxable business investment. In the case of a business investment yielding \$1,000,000 income at 6 percent, an investor would have approximately \$321,000 left after payment of Federal income tax. If an equivalent amount of capital were invested in 3½-percent tax-exempts, the investor would have a yield from his investment of approximately \$583,000. Thus, even at present, he would have a \$262,000 inducement to invest in tax-exempts, and by reason of the pending bill he will not only have the added inducement of further tax savings, but the increased security of his investment.

#### PROPOSED SCHEME WILL INCREASE COMPLEXITIES OF TAX DETERMINATION

So far as the simplification of corporate taxation and accounting is concerned, the proposed scheme, instead of contributing to that end, will greatly multiply present difficulties and add a maze of new complexities.

Under the present law, all a corporation has to do is compute its net income and pay a fixed rate of tax. The proposed scheme picks up where the present law leaves off, and after a corporation has computed its "net income" it must make other computations to determine its "adjusted net income." Then it must determine its "undistributed net income." The latter cannot be determined until a corporation has decided upon its dividend and reserve policies, but these cannot be determined until the corporation knows what penalty taxes it will have to pay if it decides upon one course or another. So, with the rate of tax affecting the dividend policy, and the dividend policy affecting the rate of tax, the corporation will be hard-pressed to know what to do.

One well-informed witness at the hearing, who has had a great deal of practical experience in connection with the drafting and administration of tax measures, stated that the proposed scheme would be a "trap for the unwary" and would penalize the "poorly advised." We think that it will also be a Chinese puzzle to the most able boards of directors, the most learned lawyers, and the most skilled accountants.

Under the present tax system the officers of a corporation know at all times precisely what rate of tax the corporation must pay, but under the scheme proposed they must make complicated adjustments as set forth in section 13 under schedules I, II, and III. A mere reading of these schedules ought to convince even the most earnest proponent of the bill that it is anything but a "simplification" measure.

#### NO TIME TO JEOPARDIZE FEDERAL REVENUE BY EXPERIMENTING WITH NEW TAX SCHEME

While intended to increase the Federal revenue, the bill actually jeopardizes the revenue by abandoning an assured collection of \$1,100,000,000 from existing corporate taxes for an uncertain and speculative yield from a new and untried scheme of taxation. It is significant that up to the time the bill was ordered reported to the House the Treasury had not even attempted to make an estimate of

the possible yield from the proposed tax. The chairman of the committee has been reported in the press as stating that the "reform" aspects of the bill are equally if not more important than the revenue aspects. However, with the public debt mounting at the rate of several billions each year and no end in sight, with no serious effort to balance the Budget being made, and with the Federal credit already stretched to the utmost, we believe that it is both dangerous and foolhardy to experiment with the Federal revenues at this time.

ALLEN T. TREADWAY.  
 ISAAC BACHARACH.  
 FRANK CROWTHER.  
 HAROLD KNUTSON.  
 DANIEL A. REED.  
 ROY O. WOODRUFF.  
 THOMAS A. JENKINS.

Wednesday  
April 22, 1936

HMjr: Good morning -

Senator Pat  
Harrison: Good morning - Mr. Secretary, how are you?

HMjr: I'm fine, how are you?

H: All right, thank you.

HMjr: Now, look -

H: All right, I'll look and listen.

HMjr: (Laughter) All right. We've had the first chance to do a little estimating on your bill.

H: Yes

HMjr: And we've got some figures now. And what I'd like to do is to have a chance to meet with you and - and your little group, I think you call them your 'kitchen cabinet', don't you?

H: Yes - kind of a private 'kitchen - a 'kitchen cabinet', yes.

HMjr: Yes - and to show you what we've got and what I should do with it. Now I want to do whatever will be the most helpful because I appreciate very much how helpful you've been to the Treasury.

H: Well, we want to be.

HMjr: Now we've got this thing - the estimate and the figures and the lag and all that and I want to do that which would be most helpful to you.

H: How do they look?

HMjr: Well, they look - they look all right, but you - you know there's this little lag and they're going to jump on all of us for that.

H: How much do you think the lag is going to be?

HMjr: The lag? - just a - how much?

H: The first year ?

HMjr: Well, I've got this statement prepared which isn't quite ready yet, see? And the boys have written - it's about one page and that's what I'd like to go over with you.

H: Would you like for us to come down or do you want to come down here?

HMjr: I'll do whatever you say. The only thing is I'm busy from ten-thirty till twelve but after that I'm free. I've got a meeting that I just can't break from ten-thirty till twelve but after that I'm free.

H: Well, if you could come down about - say about two o'clock?

HMjr: - You couldn't make it a little later could you?

H: Well, that will be all right, yes.

HMjr: Well, let me -

H: Whatever time you say.

HMjr: Well now, could you hold the wire just a minute?

H: Yes

HMjr: Just a moment - see my schedule. Just a minute, I want to just

H: All right.

April 22, 1938

This tax bill does not produce what the House Committee thought it would. There is a lag of about a year before the full revenues will be produced by the House Committee and the House experts figured wrong. They blame the Treasury people, but Oliphant said he explained it all to them. The House Committee knows I am going up to the Senate tomorrow, but Pat Harrison will serve notice that I gave a correct statement as to how much this bill will produce. The House has heard about it and they are sore, so Oliphant came in with a prepared statement and he wanted me to call Sam Hill, Chairman of the House Sub-committee, and then give it to Pat Harrison tomorrow. After I read the statement I said, "No, I was sick; I was attacked for not appearing before the House Committee and Pat Harrison came to my defense and the first day I was back at the office he called on me, so I will be nice to him." He (Oliphant) said, "What will you do?" and I said, "Let them give out the statement today and let them have the credit, rather than let the Senate make a monkey out of the House." As soon as I suggested that Oliphant said it was 'a natural'. I called up Pat to arrange for a talk and he said, "Will I come down or will you come up to us?" and I said, "I will come up to you."

Thursday  
April 24, 1936

Operator: Senator Harrison -

Pat

Harrison: Hello -

HMjr: Hello, Pat?

H: Yes, Henry

HMjr: How are you?

H: Pretty good this morning.

HMjr: Well, I wish I were - (Laughter)

H: What's the matter with you?

HMjr: Oh - I got out of bed - the doctor said I shouldn't  
but I wanted to come up and make an appearance. - Pat -

H: Well, I wouldn't if you're - unless you just feel  
like - of course I think it's a nice thing just to  
come.

HMjr: Well, I thought - what I was calling you up for, I  
thought I'd come up, say that these are the people who  
are the Treasury experts -

H: Yes

HMjr: And that I'd vouch for them - there and then I'd like  
to excuse myself.

H: All right.

HMjr: How would that be?

H: You do what you want to do, that's all right.

HMjr: Well I - I'd just like to - because there has been so  
much talk in the paper about my not coming and not making  
an appearance --

H: That's all right. You drop up and excuse yourself.

HMjr: And I'll just come up and introduce them and vouch for  
them -

H: All right, Henry.

HMjr: - and then excuse myself.

H: Yes

HMjr: Thank you, Pat.

H: I hope you'll get all right.

HMjr: Well, it's - I get - I must have eaten something or other that didn't agree with me and I was up all night.

H: I see, well --

HMjr: It'll pass off but it's just - I had something, I don't know whether it was the oysters last night or something that must of been bad.

H: Yes, a little ptomaine poisoning.

HMjr: I'm afraid so.

H: All right, Henry.

HMjr: Thank you.

Estimate of  
Yield of House  
Bill

4-22-36.  
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B.

The tax bill as reported by the Ways and Means Committee of the House is estimated by the Treasury to yield additional revenue as follows:

- (a) net continuing revenue of \$625,000,000 per annum from the tax on corporate earnings, and
- (b) net temporary revenue of \$180,000,000 from the windfall tax and temporary extension of the capital stock tax.

In consequence, this bill would fully provide the ~~\$620,000,000~~ needed to take care of the permanent agriculture program and the annual financing of the payment of the soldiers bonus. It fully provides for the first year of a three year period for recouping the loss of \$517,000,000 of processing taxes lost during the fiscal year 1936.

The estimate of a yield of \$625,000,000 from the tax on corporate earnings assumes that such tax has become fully operative. During the first year there will be, of course, some lag in the collection of this tax as is usually true when taxes are shifted from one basis to another. On an estimated average retention of 30% of corporate earnings, this lag would amount to \$128,000,000 during the calendar year 1937.

The Congress can, and I hope will, eliminate substantially all of this lag by adding a provision which would require individual and corporate taxpayers to include in their returns for each taxable year dividends received during a twelve-month period ending two months later than the taxable year. The period during which dividends paid by a corporation could be credited would be changed to correspond;

that is, it would end two, instead of two-and-a-half, months later than the corporation's taxable year. Dividends received by individuals during January and February of 1936 could be given special treatment so that they would not raise the individual's top surtax brackets and they might be exempted from the 4% normal tax. Dividends received during January and February of 1936 by corporations subject to the new plan might be subjected to substantially the same tax which they would bear under present law, instead of being subjected to the undistributed income tax.

TREASURY'S ESTIMATE OF ADDITIONAL REVENUE WHICH  
WOULD BE YIELDED BY THE TAX BILL AS REPORTED  
BY THE WAYS AND MEANS COMMITTEE OF THE HOUSE

A. Continuing Revenue

General Tax on Corporate Earnings . . . . .	\$591,000,000	
Tax on Liquidating Dividends . . . . .	33,000,000	
Additional Tax from non-resident aliens . . . . .	4,000,000	
Total . . . . .	<u>\$628,000,000</u>	
Deduct for debt retirement provisions, etc. . . . .	<u>5,000,000</u>	
Net . . . . .	<u>\$623,000,000</u>	<u>620,000,000</u>

B. Temporary Revenue

Unjust Enrichment Tax . . . . .	\$100,000,000	
Temporary Extension of Capital Stock Tax . . . . .	80,000,000	<u>83,000,000</u>
Total . . . . .	<u>\$180,000,000</u>	

803.

803

April 22, 1938

The 9:30 group meeting was held this morning.

Gibbons reported that Mr. Franklin of the International Mercantile Marine was under the impression that there was a big shipment of silver coming over from England and that he wanted the business. HM, Jr.'s answer was that as far as he knows, every bit of silver that we have brought over from England into the Port of New York came over in Franklin's ships.

Bell reported that RFC held, on April 20, municipal and railroad securities taken from the Public Works Administration in the amount of approximately \$153,000,000 and that PWA on that date held additional securities in an approximate amount of \$135,900,000. HM, Jr. asked Bell to write a letter following up the telephone agreement with Jesse Jones to the effect that RFC would sell as many of these holdings as possible prior to June 1 and not sell any during the month of June. Copy of the letter is attached.

Gibbons reported that a complaint had been received concerning Mrs. Whittemore, Collector of Customs at Puerto Rico. He said that the charge was that Sr. Dionisio Trigo, an importer of San Juan and a friend of Mrs. Whittemore's for several years prior to her appointment as Collector, presented her with a Spanish chest and other articles which were valued by the customs examiner at the time of importation at \$30.00 and entry was permitted upon the payment of duty in the amount of \$13.50. A reappraisal of the chest and other articles at a later date indicated the value to be \$882.00.

HM, Jr. directed that an investigation be made and Gibbons said one had been made and the opinion was she is guilty. HM, Jr. directed that the necessary charges against her be prepared.

Gaston reported that a letter had been received from Stewart MacDonald inquiring whether he could put a letter in with the bonus checks to be mailed to the veterans suggesting that they use their checks to avail themselves of the facilities of the FHA. HM, Jr. response was, "Obviously the answer is No."

April 22, 1936.

My dear Jesse:

It is my understanding that the Reconstruction Finance Corporation held on April 20th, municipal and railroad securities taken from the Public Works Administration in an aggregate of some \$153,000,000, and that on that same date, the Public Works Administration held additional securities in an amount of some \$135,900,000.

It has seemed desirable to me, as I have suggested to you, that the Corporation market as many as possible of these holdings, and other similar holdings, and so reduce its inventories, prior to June 1, and refrain from entering the market during June. I understand this suggestion meets with your approval, and that you are agreeable to following it. The June financing of the Treasury will be benefited, I believe, if this course is pursued.

I shall appreciate it if you will let me know that we are in agreement.

Sincerely yours,

*(Signed) Henry Morgenthau, Jr.*

The Honorable,  
Jesse Jones, Chairman,  
Reconstruction Finance Corporation.

CBU LB

April 22, 1938

The Junior League Democratic organization in New York wants a speaker to defend the Administration and Peter Grim has been suggested. Farley is checking, through Mr. Gibbons, with Mr. Morgenthau as to whether it is all right for Peter Grimm to speak. HM, Jr. approved of having Grim make the speech.

April 22, 1936.

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A group met in the office of the Secretary of the Treasury at 11 A.M. to discuss financing. Those present were:

Henry Morgenthau, Jr. Secretary of the Treasury,

Wayne C. Taylor, Assistant Secretary of the Treasury,

D.W. Bell, Assistant to the Secretary,

Joseph P. Broderick, Vice Chairman of the Board of Governors of the Federal Reserve System,

E.A. Goldenweiser, Director of Research & Statistics, Federal Reserve Board,

M.S. Eccles, Chairman, Board of Governors of the Federal Reserve System,

George Harrison, President of the Federal Reserve Bank of New York,

W.R. Burgess, Vice President of the Federal Reserve Bank of New York,

L.H. Seltzer, Research & Statistics, Treasury Department,

C.B. Upham, Assistant to the Secretary.

(During the discussion on gold at the close of the meeting, Mr. Lochhead was also present.)

Mr. Eccles reported that the Board of Governors of the Federal Reserve System with four members present (not including Mr. Broderick who was, however, in agreement with the decision of the Board) discussed the matter of increasing required reserves. They concluded that any announcement made with respect thereto and the effective date of action thereon will be fixed not later than May 15th or deferred until after July 1, so as not to interfere with the June financing of the Treasury.

Asked by Mr. Morgenthau if he thought action would be taken before May 15th, Mr. Eccles replied that he did not know -- that there is a variety of opinion and that no decision has been reached. He added that he understood the Secretary's position to be that he wished

to assume no part in, or responsibility for, the decision.

Mr. Morgenthau replied that that was true very definitely and added that he is interested in the timing of it only and has no wish to share in the Federal Reserve function of fixing reserve requirements.

Mr. Eccles asked if it would be possible to make the announcement any time after June 15th or if the announcement must be deferred until July 1st or later.

Mr. Morgenthau was of the opinion that it should wait until July 1, and with this Mr. Burgess and Mr. Bell voiced agreement -- that any earlier announcement would be an evidence of bad faith. The Street should be given some chance for distribution of the June bonds.

Mr. Eccles agreed that it would not be a pressing matter -- that if action is deferred until after June 15th there will be no hurry then.

The group then took up Treasury financing plans.

Mr. Bell outlined a variation of the plans discussed a week ago and said there was now favor for a program which would include the raising of \$1 billion in new money on June 15th, and \$600 million of new money on September 15th. As a supplement \$250 million additional bills would be offered in July and \$200 million additional in August, the entire \$450 million to bear a March 15th maturity date.

Mr. Bell said that <sup>with</sup> this plan the balances at the end of each month would be: April \$1,785,000,000, May \$1,480,000,000, June \$2,326,000,000, July \$1,920,000,000, August \$1,400,000,000, September \$1,600,000,000, October \$1,200,000,000, November \$870,000,000 and

December \$1,300,000,000.

It was suggested that there might be some adjustment as between the June and September new money offerings, reducing the \$1 billion in June and increasing the \$600 million in September.

It was suggested also that the bill offerings could be made flexible.

Mr. Bell gave as a rough guess that the veterans would ask for \$500 million in cash in July, \$450 million in August, \$300 million in September and \$100 million in October. He said the working balance could stand even greater demands than these.

Mr. Harrison said that he thought the program had great flexibility and was sound and he liked the idea of doing nothing until June.

Mr. Morgenthau brought Mr. Eccles up to date on the plans we had discussed a week ago and renewed again his reluctance to accumulate too big cash balances.

Mr. Eccles commented that excess reserves are being cut down, amounting now to only \$2,500,000,000 and being less by some \$800 million than the top figure. It was thought they would be back to \$3 billion by June 15th in view of the fact, among other things, that the Treasury will spend between now and then some \$600 million.

Mr. Morgenthau displayed a chart of Treasury receipts and expenditures which seemed to indicate, he pointed out, that we have passed the peak of expenditures in the last week in March.

Mr. Burgess asked how tax receipts in March compared with estimates and he was told that they were nine-tenths of one percent over the estimates.

Mr. Burgess said that he liked the program very much. In view of possible action by the Reserve System on reserve funds and in view of the already large Treasury balance, he thinks it wise not to finance in May. He would stick to quarterly financing. The bill program can be treated with flexibility. We will be taking the money when we have to have it -- which is wise.

Mr. Eccles expressed himself as being in favor of quarterly financing. He thought we could offer \$1 billion in June in view of the condition of the market as a result of an excess of funds seeking investment.

It was agreed that it was too early to discuss the kind of an offering to be made in June.

Mr. Goldenweiser said that he felt much the same as Mr. Eccles. He referred to some figures that had been prepared on the changes in identical deposits in the one hundred largest banks between October 1933 and November 1935. They indicated the largest increases in the accounts of financial organizations such as insurance companies and trust departments of banks. The latter, he said, showed an increase of 240%.

Mr. Broderick said that the program looked good to him. He commented that with refinancing we would have a \$2 billion offering in June. He thought the flexibility of the program had considerable merit and he preferred quarterly financing.

Mr. Seltzer thought the program attractive for the reasons already mentioned.

Mr. Harrison said he regarded it as much the best program suggested so far. It gives the Treasury every break and it adheres to the

principles of quarterly financing and reasonable cash balances.

Mr. Morgenthau then said that he would like to discuss with the group the matter of gold and the present European situation. He referred to the fact that the French elections are approaching, that the Franc is below the gold point and that we may have a crisis over the coming week end. He referred in passing to the fact that New York banks yesterday moved gold out of England perhaps at a loss. He wondered if it were possible for the United States to take any action until something actually happens abroad. He referred to the fact that we have prepared documents, ready for final signature and quick issuance if necessary, making it possible for countries not on the gold standard to buy gold in this country. His personal opinion is that the thing for us to do is wait and not give up the right to require licenses from such countries to buy gold, without some quid pro quo. If England, losing the Franc as a fulcrum for sterling operations uses the United States as a springboard we should get some agreement from them to keep the pound within certain points up and down.

Mr. Goldenweiser was of the opinion that France will not devalue, if anything, but merely place an embargo on gold.

Mr. Morgenthau said that even so the Franc would be gone as a tie for sterling and England would have nothing left to tie to.

Mr. Eccles was of the opinion that capital would not flow out of this country back to France unless the Franc were definitely stabilized at some point.

Mr. Harrison commented that even if the Franc were given a fixed gold content there would still be the fear of war in Europe

and we would probably not lose any great amount of gold so long as the political situation continued as it is.

Mr. Morgenthau referred to a recent communication from the New York Federal Reserve Bank suggesting that we let the Bank of England buy gold freely in this market.

Mr. Morgenthau said he disagreed with the New York bank on a fundamental point. We have an advantage under the present situation and he does not want to give this privilege to England unless they agree to some kind of pound stabilization within fixed points.

Mr. Harrison said that the matter could be argued two ways. Suppose we do nothing and the gold block goes off gold. England then has an excuse to let the pound go where it will rather than keep it stable with the dollar. If the Bank of England had authority today to buy gold it would be no help to them in supporting the pound. They could only use it to depress the pound and support the dollar. They first must have an opportunity to acquire dollars. If they could do this well in advance of French action through a full gold market here it would make it possible for the British Stabilization Fund to acquire dollars to sell when it becomes necessary to support the pound.

Mr. Morgenthau said that with the exception of certain special small licenses to South American countries, issued for special purposes, the only central bank of a country not on gold to definitely ask for the right to earmark gold in this country or buy dollars came from Sweden, and that he has asked the Governor of the Bank of Sweden to come here in May to discuss the matter. It later appeared that even though no assurances were given that they could withdraw gold

from this country they bought dollars anyway and are carrying dollar balances here.

Mr. Harrison said perhaps the English think they are smarter than we are and for that reason do not ask us so that we will have no argument against their action in letting the pound go where it will.

Mr. Morgenthau asked who would be hurt if the pound went down and Mr. Harrison thought it would be a disadvantage for the dollar to go up.

Mr. Morgenthau said that if the pound went down British exports would be benefited and wonders why they did not let it go down.

Mr. Harrison replied that they had been playing the game because of their belief in the virtues of stabilization.

Mr. Eccles added that because many currencies are tied to the pound they must maintain stability for the benefit of the sterling area. He thought it wise to get an agreement such as the Secretary suggested and then if Great Britain finds they cannot stay within the points fixed there can be further negotiations.

Mr. Harrison commented that we now take gold at will from England and added that if we can force Great Britain to enter into such an agreement as the Secretary suggests, he is for it 100 per cent. England for two years has managed the pound and achieved a fair degree of stability for their paper currency. This has been possible because they have had a market in Paris for France to convert to gold to support the pound with a free hand. They have been behaving. If you take away the Franc as a fulcrum perhaps they can't behave any longer. He would be better satisfied with an agreement if it can be

secured, but if it cannot be would recommend consideration of action without it.

Mr. Lochhead said that even if we were to let the Bank of England buy gold that could affect the market only one way. They will have gold rather than dollars and ~~not~~ not build up a dollar balance as Mr. Harrison suggests. He added that we now will buy gold in London for dollars.

Mr. Harrison said that in the event something happens in Europe the tendency will be for a strong pound. Then the Bank of England will want to sell pounds and buy dollars, but not unless they can convert the dollars into gold.

Mr. Lochhead commented that Sweden took a chance and bought dollars anyway without any guaranty to convert them into gold.

Mr. Harrison said he thought the Treasury was right on theory -- when we went back on gold to limit gold withdrawals to gold countries. He commented that we have a huge stock of gold and in the interest of stabilization can we not open the gold market to all central banks and governments as a part of our general program. He added that we can always stop if and when we want to.

Mr. Morgenthau thought it would be a sign of weakness to stop.

Mr. Harrison said that we would only stop to keep England from rocking us.

Mr. Eccles suggested the possibility of announcing that the new policy would continue as long as they played fair.

Mr. Harrison said that having waited this long he wouldn't take any action this week.

Mr. Morgenthau suggested the possibility of one reason Great Britain is willing to support France as she is doing is they don't know what we would do if they withdrew their support.

Mr. Goldenweiser thought it would be a serious step to cancel the right to withdraw gold if it were once granted.

Mr. Harrison replied that only a very serious cause would bring about such a cancellation. He referred to a financial war as a serious cause.

Mr. Broderick suggested that we have control now and that under Mr. Harrison's suggestion Great Britain would have.

Mr. Taylor suggested that if France merely revalues from one gold content to another we will have no problem.

Mr. Eccles commented on reserve board interest in the situation. He said that gold imports for the last two years have gone into the stock market to a very large extent. British and French and others sold their money when it was high and bought dollars and with the dollars bargain securities. It would be natural for them to want to sell out here, convert back into their own currencies and make a double profit. If stability and peace come to Europe they will be able to pull out of the United States to their own advantage.

Mr. Burgess and Mr. Bell have arranged for a meeting in the Treasury the week of May 11th, to be attended by representatives of the Reserve Banks to give attention to the elimination of "padding" in subscriptions to Treasury issues.

DEPARTMENT OF STATE  
DIVISION OF FAR EASTERN AFFAIRS

41

Conversation.

April 22, 1936.

CONFIDENTIAL

The Secretary of the Treasury,  
Henry Morgenthau, Jr.

Mr. Yutaro Tomita, Financial  
Commissioner of the Japanese  
Government and Financial Attaché  
of the Japanese Embassies at  
Washington, London and Paris.

Present:

The Japanese Ambassador,  
Mr. Hiroshi Saito.

Mr. Harukage Ukawa, Assistant  
Financial Attaché of Japanese  
Embassy, Washington.

Mr. Hornbeck.

This conversation was held on the initiative of the Japanese Embassy, on behalf of Mr. Tomita. The Embassy having asked for an appointment, the Secretary of the Treasury invited the Ambassador and Mr. Tomita to come to his house. Mr. Morgenthau asked that Mr. Hornbeck bring the Ambassador and Mr. Tomita. Mr. Tomita was accompanied by Mr. Ukawa. The conversation took place in Mr. Morgenthau's library, tea being served, and lasted for a little over an hour.

The conversation began with pleasantries on the subjects of golf and horseback riding.

Mr. Tomita

Mr. Tomita said the people in Paris had been very much interested in Mr. Morgenthau's visit to Europe last year and had wondered what had been the purpose and what matters had been under discussion. Mr. Morgenthau gave an account of a dinner which he had had with the Governor of the Bank of France, at the Bank, and of the Governor's apartment and the tapestries therein. He remarked that people never will believe, when one is on a vacation, that such is the fact. ¶ Mr. Tomita raised various questions with regard to financial matters and Treasury and banking activities in the United States. Mr. Morgenthau gave an account of funding operations, rates of interest, payments to be taken care of in the immediate future, etc. He said that, barring unexpected developments, he estimated that he would be able to balance the budget in 1938. We have gold and silver in the Treasury in the ratio of 1.80 to 1 against money outstanding. Interest rate on our Government indebtedness averages 2-1/2 per cent. As the debt increases, the prevalent rate of interest decreases. Purchasing of stocks is being done on a cash basis. Much money is coming from abroad for purchase of stocks. This is partly because of conditions of fear elsewhere, and when confidence returns in those countries where there now is fear the tide may turn.

Mr. Tomita

Mr. Tomita asked what use was being made of the gold and silver in the Treasury. Mr. Morgenthau replied that it was "insurance", that it gave assurance against a financial "attack" from abroad. So long as we have this, others are not likely to try to "attack" us.

Mr. Tomita inquired with regard to the use of the stabilization fund. Mr. Morgenthau said that no criticisms had been made of the use of that fund; there had been no indication of any desire of Congress to inquire about its use; he, Mr. Morgenthau, made no reports about it to anyone except the President; and no account had to be given before the end of another year. There followed some discussion of the method followed by the British Government with its stabilization fund and the name of the British official who administers that fund. Mr. Morgenthau named the official (in the British Treasury); Mr. Tomita said that he did not know what official it was.

Mr. Tomita said that he was unable to find the connecting link between certain figures relating to funds of the Federal Reserve. Mr. Morgenthau explained that there are funds of the Federal Reserve System and funds of the Federal Reserve Banks. He said that all of the figures are available in the (weekly) Federal Reserve reports. He would be glad to give Mr. Tomita the figures which he wanted. There was concurrence in the view that Mr. Ukawa had available the figures.

Mr. Tomita

Mr. Tomita said that, before Sir Frederick Leith-Ross went to China, he had talked with Leith-Ross. As an aside, he remarked that he, Tomita, had been in charge of Japan's financial relations with China for a period of twenty years. He said that Leith-Ross had said that China might pursue a financial course such as has been followed in "Manchukuo". He, Tomita, had told Leith-Ross that this was not possible, as the situations were different: that in Manchuria there was a strong central bank which Japan had backed and with which Japanese banks cooperated; that in China there was no such situation. Nevertheless, he said, the Chinese had tried to proceed on the line which had been followed in Manchuria; and, he remarked, the attempt at monetary reform in China was not proving successful. It looked to be successful in the neighborhood of Shanghai, but in other regions, especially in the interior, such was not the case. "Shanghai currency" did not circulate in the interior. Mr. Morgenthau suggested that it was "Nanking currency". Mr. Tomita said that "Nanking currency" was in fact Shanghai currency, and he repeated that the monetary reform was not succeeding. Mr. Morgenthau said that in his opinion it had gotten on remarkably well, considering the short time -- since November 4, 1935 -- that it had been under way. He pointed out that the banks of other countries had turned in their silver -- with the exception of the Japanese banks. Mr. Tomita said that the Japanese banks had not turned their  
silver

silver in because they were convinced that the monetary reform would not succeed. Mr. Morgenthau remarked that the Japanese banks are holding out about \$10,000,000. Mr. Tomita turned to the Japanese Ambassador and said: "They have not made up their minds".

At that point the Japanese Ambassador indicated that he thought it was time to bring the call to an end.

There followed the usual exchange of courtesies and departure of the Japanese guests.

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Mr. Morgenthau held Mr. Hornbeck back. He requested that Mr. Hornbeck make a memorandum of the conversation. He asked for Mr. Hornbeck's opinion of the interview. Mr. Hornbeck said that he thought that Mr. Morgenthau had said just those things which would produce the to-be-desired impression; that he had brought out in vigorous relief the strength of our public financial situation and position. Mr. Morgenthau remarked that he had had to "give it to" Mr. Tomita on the matter of the Chinese monetary reform. Mr. Hornbeck replied that such was the case but that Mr. Tomita "had asked for it" and that it was well for him to have been given the clear indication that the sympathy of the Secretary of the Treasury of the American Government is with the Chinese in their effort at monetary reform and that

and that we look with disfavor on Japan's placing of obstacles. Mr. Morgenthau said that he had told the Chinese bankers of Mr. Tomita's impending appearance in Washington and that the Chinese bankers had pressed him yesterday for a commitment, which he had refused to make. He said that they were apparently nervous over Tomita's approach. Mr. Hornbeck told Mr. Morgenthau the story of the arrival of Tang Shao-yi and the signing of the Root-Takahira Agreement -- in 1908.

There followed some discussion of the purpose of Tomita's visit to Washington. This visit may have been timed deliberately to take place while the Chinese bankers are here; but Mr. Tomita apparently has no message to deliver on behalf of his Government and no proposals to make; he may desire to make a certain impression through the publicity which may be given in the Far East to the fact of his being here and making certain calls at this moment; he is on his way home from London to Tokyo; he is here for two days only; he of course desires to be able to say at home that he has made contacts with high officials here, and he of course desires to pick up any information which may be of use to him either from a technical or from a political point of view. (NOTE: In the earlier stages of the conversation, the Japanese Ambassador remarked that Mr. Tomita had been talked of as a possible head for the Ministry of Commerce and Industry.) Mr. Morgenthau asked

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for Mr. Hornbeck's opinion in regard to his having held this interview at his home rather than at his office. Mr. Hornbeck said that he felt that it had been very good strategy; he felt that the Japanese would feel that special courtesies had been shown them, and, at the same time, publicity would be avoided.

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(Note: At one point in the conversation -- while the question of balancing the United States budget was under reference --, Mr. Morgenthau made the observation that in Japan about one-half of the Japanese Government's expenditures goes to military matters.)

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# TREASURY DEPARTMENT

48

## INTER OFFICE COMMUNICATION

DATE April 24, 1936.

TO Secretary Morgenthau

FROM Mr. Taylor

Subject: Substance of conference of the Chinese representatives - Mr. Chen and Mr. Koo - with Treasury representatives - Mr. Taylor, Mr. Lochhead, and Mr. White - 2:30 P. M., April 23, 1936.

### SUMMARY

#### 1. Proceeds of sales of silver by China.

Mr. Chen reported that his Government informed him that the proceeds of the recent sale of silver by China would be transferred to New York.

#### 2. New silver coins.

Mr. Chen decided to recommend to his Government that the new yuan and half-yuan coins be minted to contain .288 ounces of net silver content. The yuan coin is to have a gross weight of .40 ounces - approximately the size of our 50-cent piece - and a fineness of .720. The half-yuan coin - approximately the size of our 25-cent piece - is to consist of about one-half the above silver content.

The opinion was expressed that if these coins are adopted about 200 to 250 million ounces of silver would go into circulation during the next twelve months.

#### 3. Increased use of silver in the arts.

The maximum proportion of silver permitted by the decree of November, 1936, to be used in the manufacture of silver articles is 30 per cent. Mr. Chen agreed to recommend to his Government that the percentage be substantially increased. Mr. Chen was going to obtain for inclusion in his memorandum an estimate of the added amount of silver likely to be consumed as a consequence of the increase in the proportion of silver that silversmiths would be permitted to use.

#### 4. Silver reserve against note issue.

After lengthy discussion, Mr. Chen agreed to suggest to his Government that they give serious consideration to the plan of maintaining a minimum reserve of 25 per cent of the outstanding note

Secretary Morgenthau - 2 - (Summary)

issue in silver (valued at its metallic content). Gold and foreign exchange would constitute the fluctuating proportion of the cash reserves.

5. Fixing of the yuan exchange rate.

Mr. Chen indicated his intention of reporting to his Government that it appeared that the yuan was pegged to sterling. Mr. Chen and Mr. Koo expressed the view that the explanation of the fixity of the official sterling-yuan rate probably was that the man in charge of the exchange operations in the Bank of China felt it more convenient to keep the sterling rate unchanged, and was not cognizant of the interpretation that was being made of such action by observers here in Washington.

## TREASURY DEPARTMENT

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## INTER OFFICE COMMUNICATION

DATE April 24, 1936.

TO Secretary Morgenthau

FROM Mr. Taylor

Subject: Substance of conference of the Chinese representatives -  
Mr. Chen and Mr. Koo - with Treasury representatives -  
Mr. Taylor, Mr. Lochhead, and Mr. White - 2:30 P. M.,  
April 23, 1936.

1. Proceeds of sales of silver by China.

Mr. Chen opened the meeting by stating that he was happy to report he had received a cablegram from his Government stating that the proceeds of the recent sale of silver by China in London would be transferred to New York.

2. New silver coins.

Mr. Chen presented four alternative combinations of size and fineness of silver coins which they had under consideration as a result of their conference with our Mint experts.

Mr. Chen stated that the choice which appealed to them most was the coin with a gross weight in ounces of .40 which contained .288 ounces of silver, having a fineness of .720. That makes a coin of approximately the size of our half dollar, with a metallic value of \$.1296 when silver is 45 cents an ounce and the yuan exchange 30 cents. With silver at 45 cents an ounce, and yuan exchange at 30 cents, the Government would have a seigniorage profit of 16+ cents. The shipping point of the 30-cent yuan would be reached when silver was \$1.04 an ounce.

Mr. Chen asked to be advised by the Treasury representatives with regard to their choice. The reply was that the Treasury representatives could not, of course, advise them on such a matter, but that the selection made by Mr. Chen and Mr. Koo seemed to be a happy one, with many advantages. The fineness selected was one which had a natural affinity with copper, the coin would have an excellent appearance, would wear well, and would be easy to mint. The view was expressed by the Treasury representatives that the size and metallic content of the coin was a matter which naturally the Chinese Government would wish to decide upon independently, but that it did appear the coin they selected seemed the wisest choice in the light of all the circumstances.

In response to a question, Mr. Chen and Mr. Koo both expressed the opinion that if things went well in China, China could absorb, conservatively, from 300 to 400 million yuans of coins within the next twelve months. This would mean a consumption of from 200 to 250 million ounces of silver. It was suggested that an estimate of the amount to be used be included in the memorandum which the Chinese representatives were to submit to the Secretary at their next conference with the Secretary.

The Treasury representatives suggested that it might be desirable for the Chinese Government to give some consideration to the imposition of a maximum limit upon the issue of silver coins to avoid any possible criticism that the issue of such coins was an inflationary device which might be abused by the Government (as has been the case with the issue of token coins in China in the past.)

The seigniorage profit accruing to the Government with silver at 40 cents an ounce would be quite sufficient to provide an incentive for the issue of as many silver coins as the people would find convenient to use.

### 3. Increased use of silver in the arts.

The regulation of November 1936 imposes a maximum percentage of 50 per cent pure silver which may be employed in the arts.

The Treasury representatives stressed:

- (a) The fact that so small a percentage interfered with the creation of satisfactory and artistic articles.
- (b) That the increase in percentage could result in a substantial increase in the consumption of silver because of the demand for silver objects with silver at a low price.
- (c) Their foreign sale of silver as a commodity would increase, with a resultant increase in their total reserves, as well as in their reserves of foreign exchange.
- (d) The enhanced confidence in silver's future in China that an increase in the proportion would create.

It was pointed out by the Treasury representatives that the increase in silver content is something which the Chinese silversmiths were pressing for, and that it was a change which China would sooner or later make in her own interests.

It was suggested to Mr. Chen that it would be desirable to have incorporated in his memorandum to the Secretary some statement as to the minimum proportion of increase which the Chinese Government was ready to adopt, as well as an estimate of the added amount of silver to be consumed in industry that such an increase in the percentage would result in.

4. Silver reserve against note issue.

Mr. Chen had suggested the proposal of maintaining cash reserves of 25 per cent in silver and 35 per cent in gold and foreign exchange, making a total of 60 per cent. His suggestion was followed by a lengthy discussion on the question of the make-up of cash reserves against note issue.

It was brought out that such a combination would provide no flexibility and might create difficulties for China in the management of her reserves. It was pointed out that it were better if the minimum proportion of silver were fixed, leaving the proportion of gold and foreign exchange as the flexible portion of the cash reserves to be varied or not as the occasion warranted. The view was expressed by the Treasury representatives that the Chinese Government might well consider the desirability of maintaining a minimum reserve against note issues of 25 per cent in silver (silver to be valued at its bullion value), and the balance of the cash reserve to be held in gold and foreign currency.

Mr. Chen indicated that he would transmit that suggestion to his Government for serious consideration.

The question whether the reserve should be valued at the metallic content or at its nominal value (as is done in the United States) remained a point about which little was said. The Chinese volunteered the information that they had not thought of the distinction between the nominal and market value in computing their reserves of bullion inasmuch as on the basis of the old yuan coin it made little difference. The introduction of the new coin, however, with a much smaller silver content brings the question to the fore, and makes the issue an important one.

5. Fixing of the yuan exchange rate.

Mr. Chen raised the question anew as to the justification of the view held by Treasury representatives that the yuan was linked to sterling. When Mr. Lochhead reported to him that on that very day the dollar-sterling cross-rate had altered and that the dollar-yuan rate was changed again while the sterling-yuan rate remained unchanged, Mr. Chen stated that he was left with nothing further to say on the subject.

Mr. Chen did not state definitely what he would recommend to his Government. He repeated what he said on earlier occasions - namely, that it was not the policy of his Government to link the yuan to

Secretary Morgenthau - 4/24/36, 4.

sterling. He ventured the opinion that the explanation of the matter was probably the feeling of the man in charge of exchange operations in the Bank of China that it was more convenient to keep the sterling rate fixed.

It was pointed out by the Treasury representatives that that was exactly the point at issue; that if the Bank of China was keeping the sterling rate fixed and altering the dollar rate the Chinese were in effect not carrying out the policy which was specifically indicated in their new banking legislation. Mr. Chen indicated his intention of calling the matter to his Government's attention. It was understood by the Treasury representatives that he was going to do that in any case and so the meeting resulted in nothing more definite on this point. However, it was felt that the further evidence furnished by the day's exchange operations would strengthen the position Mr. Chen could take with his own Government with respect to the view that the yuan was -- to all appearances -- being linked to sterling.

Mr. Chen expressed the intention of preparing a memorandum for the Secretary after he had heard from his Government. He stated that he would like to submit the memorandum first to the Treasury representatives for their criticism preliminary to presenting it to the Secretary.

He also stated that he thought the memorandum would be ready to submit on Monday.

April 24, 1936

HM, Jr. in speaking to Archie Lochhead today said he had two ideas that he wanted to throw out to him. The first one was that we have no contact with the legitimate silver manufacturers and it was his idea that we buy silver at 45 cents and sell it to any manufacturer at 45 $\frac{1}{2}$  or 45 $\frac{3}{4}$  cents. Lochhead said that under the law we could not sell silver at less than \$1.28 an ounce.

His second idea was that we should get from Mexico the right to sell their silver in New York at 45 $\frac{3}{4}$  cents and reduce the loan which we made to them and for which the silver is held as collateral. We would start in by selling a million ounces to the trade, the idea being that the Federal Reserve Bank would work directly with the Bank of Mexico.

He feels that the situation is so set now that we can take care of the New York, London and Canadian markets if we can make this arrangement with Mexico, because when silver goes above 45 cents in London, China sella (which takes care of the London market) and when the price of silver goes above 45 cents in Canada, Canada would sell in their market (which takes care of the Canadian market) and if we have this arrangement with Mexico, the New York market would be taken care of.

HM, Jr. will discuss these two points further with Lochhead on Monday after the Secretary gets back from the farm.

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HM, Jr. told Bell today that he has completely changed his mind, since Wednesday's meeting, in regard to the financing for the next couple of months. The reason he wants to raise this extra money at this time is that should the bond market, because of world conditions, not be favorable around the middle of June when he will have to raise \$1,000,000,000, he wants to be prepared by having this extra \$450,000,000 on hand so that Wall Street will not "hold a pistol to his head."

TO: THE SECRETARY

In accordance with your instruction, a copy of this was delivered to the State Department this morning.

Under Secretary Phillips was out of the city, but Mr. Whitaker and I conferred at length on the subject with Assistant Secretary Moore and Mr. Hickerson.

My opinion is that we can count on full cooperation from the State Department in any course of action which we may consider necessary.

From: MR. GRAVES

April 24, 1936

Graves reported that a copy of the attached memorandum was delivered to the State Department this morning.

Under Secretary Phillips was out of the city, but Mr. Whitaker and Graves conferred at length on the subject with Assistant Secretary Moore and Mr. Hickerson.

Graves' opinion is that we can count on full cooperation from the State Department in any course of action which we may consider necessary.



TREASURY DEPARTMENT

WASHINGTON

April 24, 1936.

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MEMORANDUM FOR THE SECRETARY:

In accordance with your request, I am glad to supply you with the following brief report of the conferences which began Monday, April 20, with the Canadian distillers.

The companies and their representatives are as follows:

Distillers Corporation-Seagrams..... Mr. Phillips  
Hiram Walker-Gooderham and Worts..... Mr. Lash  
United Distillers..... Mr. Locke  
Consolidated Distillers..... Mr. Forsythe

The Government's representatives are:

For the Department of Justice, Mr. McMahon, Assistant Attorney General, and Messrs. Whitaker and Parrish, Special Assistants to the Attorney General.

For the Treasury Department, Messrs. Graves and Frank.

In the memorandum handed to Under Secretary Phillips by Mr. Wrong on April 15, certain "observations" were made on behalf of the Canadian companies with reference to some of the provisions of the memorandum which had been handed to Mr. Wrong by Mr. Phillips on April 10, constituting the basis for the proposed negotiations. Among other things, these "observations" covered two important points, as follows:

(a) With respect to the provision that the companies' representatives should come to the conferences "empowered then and there to bind their principals," it was suggested

on behalf of the companies that this provision should be modified so as to allow any agreements which might be reached between the Government and the companies' representatives to be made subject to ratification by the companies "within one week" after the conclusion of the conferences.

(b) With respect to the proposal that the Government should not be called upon to disclose the particulars of its claims or to discuss the facts or law supporting them, it was suggested by the Canadian Government that sufficient information should be furnished to permit an effort to be made to reach settlement.

With a view to clearing up these and certain other points of a relatively minor character, preliminary conferences were held separately with representatives of the companies on Monday, April 20. At these preliminary conferences, the Government's conferees accepted the reservation described in subparagraph (a) above. With respect to the reservation covered by subparagraph (b), the Government's conferees advised the companies' representatives that the amount of the claim would be stated in each case. They also advised each company that the claim arose out of the bringing into the United States of its liquor, if not directly by the company, then with the company's aid, assistance, or connivance; and that the liability was under the customs, excise, and income-tax laws. But the companies' representatives were informed in each case that beyond these statements no further disclosure would be made. (The income-tax liability was, however, subsequently stated separately.) In each case, the companies' representatives indicated a willingness to proceed with the negotiations with this understanding.

It is important to note that Mr. Lash, representing the Hiram Walker Company, stated at the preliminary conference that neither he

nor, so far as he knew, any other person representing his company had at any time requested the Canadian Government to arrange for conferences with representatives of this Government on behalf of his company. He said that so far as he was aware these conferences had been requested by the Treasury Department, and that he had come to Washington on that assumption. He denied any familiarity with the arrangement outlined in Mr. Wrong's memorandum of April 15, and indicated that he did not consider his company bound by that memorandum. He said further, however, that inasmuch as he was in Washington he would be willing to proceed with negotiations along the lines indicated by the memoranda which had been exchanged between the two Governments.

Following these preliminary conversations, conferences were subsequently held with the representatives of the companies, with results substantially as follows:

Seagrams.

The amount of the claim against this company was stated as \$25,183,292.53. Mr. Phillips asked for, and was granted, time (almost two days) in which to confer with his principals with regard to the submission of an offer in compromise. He finally submitted such an offer in the amount of \$500,000. He was advised that this was unacceptable, but he stated that this was the maximum which his company was prepared to offer. Mr. Phillips was totally unprepared, and apparently unwilling, to make any suggestions whatsoever with reference to the second alternative which was to be the subject of discussion at the conferences. Only when pressed by the Government's conferees,

did he agree to consider this alternative at all, and then only with the understanding that he was to be permitted several days additional time to consult further with interested parties. He was allowed, at his request, until Monday, April 27, to consult with these interested parties, at which time he is expected to make some kind of a proposal with regard to the question of submitting to the jurisdiction of the United States courts and providing security for the payment of any judgment which may be obtained against his company. Mr. Phillips asked to be informed, and was informed, (1) of the probable venue of the Government's proposed action; (2) of the names of all principal defendants; and (3) of the nature of the action which the Government proposed to bring against his principals.

Hiram Walker.

As has been stated, Mr. Lash, representing the Hiram Walker Company, was unprepared to make any proposition whatsoever respecting either of the alternatives covered by the arrangements between the two Governments. He insisted upon delaying negotiations pending the return of Mr. Hume, of the Hiram Walker Company, from abroad. The amount of the Government's claim against the Hiram Walker Company was stated to Mr. Lash as \$19,261,183.33.

United Distillers.

The amount of the claim against United Distillers was stated to Mr. Locke as \$4,433,446.13. Mr. Locke's attitude was generally satisfactory, and he indicated that he would be prepared on Monday, April 27, to make a specific offer in compromise, and, if this offer should prove

unacceptable, to make a proposal to bring his company within the jurisdiction of the United States courts and to secure payment of any judgment which might be rendered against it.

Consolidated Distillers.

The claim against Consolidated Distillers was stated as \$4,527,982.08. Mr. Forwythe likewise indicated that at the earliest possible moment, and if possible on Monday, April 27, he would submit an offer in compromise, and, if this should prove unacceptable to the Government, a proposal to bring his company into the jurisdiction of our courts and to secure the payment of any judgment which might be obtained against it.

OBSERVATIONS.

It will be observed that none of the four companies has been able to proceed in accordance with the terms of the commitments of the two Governments.

The Hiram Walker Company, as has been said, pretends to have had no knowledge of the undertaking on its supposed behalf by the Canadian Government as outlined in the memorandum of April 15. Mr. Lash came to Washington unprepared, and evidently unauthorized, to make any specific proposals or suggestions to this Government, or even to discuss the alternatives outlined in the memoranda exchanged by the two Governments, except in the most vague and general terms. He can not proceed with discussions on any basis whatsoever until the return of Mr. Hume from abroad, which is expected to be about May 1.

The representatives of none of the four companies were prepared

Memo. for the Secretary—6.

"then and there" to make proposals to this Government, subject to ratification in the manner contemplated by the "observations" contained in the Canadian memorandum of April 15. All were compelled to seek further time, after receiving notice of the amount of the Government's claims, to confer with interested parties.

In general, it may be said that the feeling of the Government's conferees is that, of the four companies involved, only two, United and Consolidated, are sincerely desirous of working out a settlement. The other two, Seagrams and Hiram Walker, have apparently no intention of making acceptable proposals. Much was said by the representatives of these latter companies of the international aspects of the problem, especially as to the attitude of the Canadian Government with regard to the proposed legislation; and the opinion of the Government's conferees is that these two companies are confident that the Canadian Government will succeed in defeating the legislation regardless of the results of the present conferences, and that they have accordingly determined to make no real effort to settle the Government's claims against them at this time.

GRAVES.

April 27, 1938

Mr. Taylor and Mr. Lochhead came in to talk to the Secretary about a cable received from Buck, from which the following is an excerpt:

"He (Kung) is concerned over rumor of Canton Government's approaching National City Bank of Hong Kong for loan with silver as security since Canton's silver is reserve for note issue. He is anxious to know National Bank's attitude in case you have information."

HM, Jr. made the suggestion that he was going to call Rentschler, but Lochhead did not think well of it because he did not feel that the Secretary would want to put himself in the position of asking the National City not to do it. Taylor, on the other hand, called Mr. Morgenthau's attention to the fact that this was a political situation and wondered if HM, Jr. wanted to take part in it.

HM, Jr. told Taylor that in order to help the Nanking Government he would go the limit; that as long as he was in the midst of this fight he would have no hesitation in asking the National City not to make the loan if it really would help the Nanking Government. He said he would not tell Mr. Rentschler not to do it, but he would put it so that he would leave it to the discretion of the National City.

Attached are copies of Lochhead's memorandum to the Secretary, Buck's cable and memoranda of two cables received from the office of the Treasury Attache at Shanghai.

Transcript of the telephone conversation between the Secretary and Mr. Rentschler follows:

HM, Jr.: Hello.

Gordon Rentschler: Hello; good morning, how are you?

HM, Jr.: I'm fine, how are you?

Mr. R.: Very good, indeed.

HM, Jr.: Mr. Rentschler, I've got a matter which has been brought to my attention and I don't know whether you are familiar with it or not. And that is that your branch in Hong Kong has been approached by Canton authorities --

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Mr. R.: Yes.

HM, Jr.: in connection with a loan on Chinese - Canton money, see?

Mr. R.: Yes, I see.

HM, Jr.: Now, seven hundred -- I'll read you what I've got.

Mr. R.: Yes.

HM, Jr.: It says, "The National City Bank, New York, advised that their Hong Kong Office was approached by Canton authorities for a loan in Hong Kong dollars equivalent to 2½ million standard Chinese dollars . . ."

Mr. R.: Yes.

HM, Jr.: which would be in the neighborhood of 750,000 U.S. dollars. The collateral was to be Chinese standard silver dollars.

Mr. R.: Yes.

HM, Jr.: Then it goes on -- we got this information from one of your men -

Mr. R.: Yes.

HM, Jr.: The City bank quoted their terms but have heard nothing further from the Canton authorities. The City Bank gave the impression and so forth that their terms quoted were of such a nature that it was not conceivable that they would be acceptable to the Canton authorities.

Mr. R.: Yes.

HM, Jr.: No, here is the point. As you know, we've been conducting negotiations with representatives of the Nanking Government and they put this thing up squarely to me.

Mr. R.: Yes.

HM, Jr.: In other words, they don't say it in so many words, but almost -- Is a National Bank going to make a loan to the Canton people when the Nanking people

-3-

are about to call a monetary conference early in May in which they are inviting the Canton people to participate?

Mr. R.: Yes.

HM,Jr.: Now, I would appreciate it if you'd personally look into this thing, see?

Mr. R.: Yes, I will. My off hand guess is that there is some error about it somewhere because I don't think we would be interested in making that loan.

HM,Jr.: Well, if you could look --

Mr. R.: I'll check it right away.

HM,Jr.: And then I'll be back here between three and four standard time.

Mr. R.: Three and four standard? I'll call you then.

HM,Jr.: Yes, and

Mr. R.: I'll have all the information by that time.

HM,Jr.: I'd appreciate it. And the other thing is, I've got to go up on the Hill to testify Thursday morning.

Mr. R.: Yes.

HM,Jr.: Now, I wondered -- and we have Cabinet Thursday afternoon, so would Friday be just as good for you?

Mr. R.: Oh, yes, just as good.

HM,Jr.: Well, let's just make it twenty-four hours later.

Mr.R.: Fine, I'll be delighted to do that.

HM,Jr.: How's that?

Mr. R.: That suits fine.

HM,Jr.: And will you call me between three and four standard?

Mr. R.: Yes, I'll call you between three and four this afternoon.

HM,Jr.: Thank you, very much.

Mr.R. : All right, fine.

HM,Jr.: Thank you.

Mr. R.: That's all right."

COPY

25 April, 1936

FROM: Spagent, Shanghai, China  
TO: Secretary of the Treasury

Message from Buck. Kung states time limit for exchanging silver coin into legal tender notes will be extended. He is concerned over rumor of Canton Government's approaching National City Bank of Hong Kong for loan with silver as security since Canton's silver is reserve for note issue. He is anxious to know National Bank's attitude in case you have information.

COPY

April 27, 1938

To: The Secretary

From: Mr. Lochhead

The National City Bank, New York, advised that their Hong Kong Office was approached by Canton authorities for a loan in Hong Kong dollars equivalent to 2-1/2 million standard Chinese dollars, which would be in the neighborhood of 750,000 U. S. Dollars. The collateral was to be Chinese standard silver dollars. The City Bank quoted their terms but have heard nothing further from the Canton authorities. The City Bank gave the impression that the terms quoted by them were of such a nature that it was not conceivable that they would be acceptable to the Canton authorities. This would be the natural course to follow rather than to give an absolute refusal to the proposition.

Tuesday  
April 28, 1936

Gordon  
Rentschler: Mr. Secretary?

HMjr: Hello, Mr. Rentschler

R: Yes, we got our wire back from China -

HMjr: Yes

R: That loan has not been made because they did not accept our terms.

HMjr: Yes

R: And of course we'll handle it from now on because it's withdrawn.

HMjr: It's withdrawn?

R: Yes - we'll just - we won't renew the offer to them.

HMjr: I see.

R: So that it will be handled and it will not be done.

HMjr: It'll be handled how?

R: I say it will be handled so that it will not - the loan will not be made.

HMjr: Well - would it be - will your people notify the Nanking Government to that effect?

R: Yes, if you would like for us to.

HMjr: I wish you would. Do you mind if I tell them here that they're going to hear from you.

R: Yes, you tell them that - you tell them just that and I'll be glad to tell our people in Nanking the same thing.

HMjr: Yes - and I can tell them that you will not make any loans - ?

R: That's right.

HMjr: Well, that's playing ball.

R: And you tell them that - will let Nanking know.

HMjr: Right - now, just while I got you on the wire -

R: Yes

HMjr: Have you heard - have you heard anything at all as to the interpretation of this latest move of putting General Goering in charge?

R: No - we're trying to find out now - and we're rather hopeful that one of our fellows will probably come out to either London or Paris where we can talk to him on the telephone.

HMjr: Well, if you get anything would you call me yourself?

R: Yes, indeed I will.

HMjr: Because I'm very very much interested.

R: Yes, we'll very likely get some kind of information - then I'll give you a ring on it.

HMjr: Thank you

R: So far we haven't been able to appraise it.

HMjr: Well, neither have we.

R: We don't like it.

HMjr: No

R: (Laughter) All right

HMjr: If you hear -

R: -Whatever we hear I'll give you a ring.

HMjr: Right

R: All right

HMjr: Thank you

R: Bye bye

HMjr: Goodbye.

COPY

CABLE RECEIVED FROM OFFICE OF TREASURY ATTACHE  
AT SHANGHAI

Understand Canton government representative approached local National City Bank for loan for industrial development in South China. Reliably informed Canton government has on hand small Canton silver coins valued at Hongkong dollars 100 million. Additional 100 million being held by local Canton merchants and other groups. Canton government evidently trying to borrow against silver they now hold. As China silver coins can not be exported from China without approval of Nanking government, only alternative would be Nanking government to take over Canton currency.

Later:

Continuing our cable regarding loans sought by Canton government. Reliable information as follows. When Hongkong manager of National City Bank of New York visited Canton last week he was approached by SHENTSUIWO (Chen Wei Chow) head of Kwang Tung Provincial Bank of Canton and SZE Hongkong manager of Kwang Tung Provincial Bank for loan for industrial development of South China. They wish to borrow as much as possible against Canton silver coin they now hold in Canton valued at over Hongkong 100 million dollars. Understand Canton government does not want to have currency taken over by Nanking. Also understand they first approached Hongkong and Shanghai Banking Corporation to sell silver and then wanted loan but were refused.

TREASURY DEPARTMENT

Washington

FOR RELEASE, MORNING NEWSPAPERS,  
Monday, April 27, 1936.  
4-24-36.

Press Service  
No. 7-25

The Secretary of the Treasury today announced that the four hundred million dollar mark, maturity value, of sales of Savings Bonds had been passed. Since the first issuance of these bonds on March 1, 1935 through April 18, 1936, cash sales of \$310,081,930.96 have been received. As Savings Bonds are sold on a discount basis and increase in ten years through accumulated interest to a total 33-1/3% greater than the purchase price, this cash sale represents a maturity value of approximately \$413,442,574.62.

During the first year in which Savings Bonds were offered to the public, March 1, 1935 to March 1, 1936, sales amounted to a maturity value of approximately \$361,561,975.00.

The January 1936 sales are the largest for any month to date, representing a maturity value of \$61,864,933.59. The highest daily record was reached on January 13, 1936, when receipts by the Treasurer of the United States for Savings Bonds represented a maturity value of \$4,313,874.08 for this single day.

The average sale of Savings Bonds, including direct-by-mail sales for each working day since the bonds were first offered, averages in excess of \$1,000,000.00, maturity value.

The Secretary of the Treasury also announced that, supplementing the sale of United States Savings Bonds by the Post Offices, arrangements have been made and agreed upon whereby the Federal Reserve Banks are also designated sales agents. The Reserve Banks will issue the Savings Bonds upon application by mail on order blanks furnished by all postmasters. The Reserve Banks will accept personal checks, subject to collection, in payment of the issue prices. Application for Savings Bonds may also be made by mail to the Treasurer of the United

States accompanied by personal check.

The new plan will expedite issuance of Savings Bonds to purchasers tendering personal checks. Postmasters will furnish envelopes addressed to the appropriate Federal Reserve Bank to those purchasers who tender personal checks. Such patrons will be advised to draw checks to the order of the Treasurer of the United States.

The new service will aid those who hesitate to carry cash on their persons in order to purchase Savings Bonds at local Post Offices.

The situation which resulted in some quarters, when at first World War Adjusted Service Bonds were confused with United States Savings Bonds, is clearing, according to indications. As Adjusted Service bonds to be issued in the denomination of \$50, and United States Savings Bonds, issued in denominations of \$25, \$50, \$100, \$500 and \$1,000, are both popularly referred to as "Baby Bonds" some confusion existed. They are, of course, two separate issues.

A tabulation of sales by States for the first full year of Savings Bond offerings indicates that the State of Illinois leads the country in sales in the amount of \$34,351,300, maturity value. New York State is second with \$24,777,536. Ohio is next in order.

The Secretary of the Treasury emphasizes that the thousands of investors who made the legal maximum purchase during the calendar year 1935 (\$10,000 maturity value for any one calendar year) are eligible to make similar maximum purchases for the calendar year 1936. This holds true whether the purchase is made for individual holdings or whether the bonds are purchased by trustees or guardians for estates or institutions.

The fixed cash redemption values, which are never less than the purchase price, are printed on the face of each United States Savings Bond.

These fixed redemption values remove these securities from any possibility of price fluctuation and permit the investor to plan for definite amounts for specific future needs on or before the maturity of the bonds.

Redemptions from March 1, 1935 to April 15, 1936 total \$7,900,000, or approximately 2-1/2% of the total sales.

An owner of a United States Savings Bond may not only redeem his bond in full, at any time after sixty days from issue date, but if he is the owner of a bond with a greater face value than the minimum face value of \$25, he may, in units of \$25, maturity value, redeem any portion of his bond and new bonds for the remainder, dated back to correspond with the original bond, will be issued.

On March 4, 1936, the Secretary of the Treasury issued, because of the increasing volume of sales, an Order creating the Division of Savings Bonds of the Treasury Department. This Division comes under the supervision of Mr. Wayne C. Taylor, Assistant Secretary of the Treasury, in charge of fiscal affairs.

Maturity value of sales of United States Savings Bonds in the several States and Possessions, March 1st, 1935 to March 1st, 1936, arranged in the order of their total sales for the first year were:

## UNITED STATES SAVINGS BONDS

Sales by States for the Period March 1, 1935 to March 1, 1936

## Maturity Value

State	Total 12 months
Illinois - - - - -	\$ 34,351,300.00
New York - - - - -	24,777,536.67
Ohio - - - - -	22,552,300.00
District of Columbia (Includes mail order sales) -	19,837,225.00
Missouri - - - - -	19,300,975.00
Iowa - - - - -	18,113,750.00
Pennsylvania - - - - -	17,218,075.00
Minnesota - - - - -	16,166,538.33
Kansas - - - - -	15,573,200.00
Texas - - - - -	14,783,700.00
Michigan - - - - -	14,571,425.00
California - - - - -	14,407,825.00
Indiana - - - - -	12,943,625.00
Wisconsin - - - - -	12,202,275.00
Nebraska - - - - -	9,250,625.00
Oklahoma - - - - -	6,248,000.00
Massachusetts - - - - -	6,040,100.00
Washington - - - - -	5,311,175.00
New Jersey - - - - -	5,300,575.00
Kentucky - - - - -	4,954,425.00
North Carolina - - - - -	4,870,125.00
Oregon - - - - -	4,519,750.00
Colorado - - - - -	4,362,800.00
West Virginia - - - - -	4,246,225.00
Tennessee - - - - -	3,879,900.00
Virginia - - - - -	3,857,175.00
Florida - - - - -	3,810,075.00
Georgia - - - - -	3,696,375.00
Montana - - - - -	3,680,100.00
North Dakota - - - - -	3,416,375.00
Arkansas - - - - -	2,712,925.00
Louisiana - - - - -	2,688,400.00
South Dakota - - - - -	2,670,625.00
Maryland - - - - -	2,661,775.00
Mississippi - - - - -	2,411,900.00
Alabama - - - - -	1,936,650.00
South Carolina - - - - -	1,847,275.00
Connecticut - - - - -	1,454,825.00
Maine - - - - -	1,285,900.00
Utah - - - - -	1,068,100.00
Idaho - - - - -	1,049,800.00
Wyoming - - - - -	817,650.00
New Mexico - - - - -	790,425.00
Arizona - - - - -	786,000.00
New Hampshire - - - - -	778,050.00
Rhode Island - - - - -	776,900.00
Vermont - - - - -	544,750.00
Nevada - - - - -	435,050.00
Hawaii - - - - -	242,725.00
Delaware - - - - -	157,125.00
Alaska - - - - -	100,625.00
Puerto Rico - - - - -	60,175.00
Virgin Islands - - - - -	33,900.00
Samoa - - - - -	6,375.00
Guam - - - - -	600.00
TOTAL	\$361,561,975.00

Draft only

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Statement of Secretary Morgenthau before the  
Senate Finance Committee, April 27, 1936.

It is my understanding that your Committee has met to consider the tax proposals contained in the President's message to the Congress of March 3rd, in order to insure prompt action when a bill to give effect to these proposals shall have been received from the House of Representatives. I welcome the opportunity to appear and discuss these proposals with you and to present the Treasury's viewpoint, because it seems to me extremely important that supplemental sources of revenue be provided in order that we may maintain the integrity of the President's Budget of January 6th and thereby keep faith with investors in the Government's obligations.

The Treasury fortunately has been able to borrow without difficulty the amounts necessary to finance the recovery program and has been able to obtain these loans at steadily decreasing interest rates. So sharp in fact has been the reduction in interest rates on new borrowings that the annual interest charges on the public debt are today no greater than were the charges some ten years ago on an amount of national debt less by some eleven billions of dollars than the present debt. The maintenance of this satisfactory situation, however, will depend upon scrupulous adherence to an orderly program looking to a balance of the federal budget just as soon as the needs and abilities of our people make that possible and thereafter upon a steady reduction in the public debt.

In his Budget Message of January 3, 1936, the President made this

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statement: "If the Congress enacts legislation at the coming session which will impose additional charges upon the Treasury, for which provision is not already made in this Budget, I strongly urge that additional taxes be provided to cover such charges. It is important as we emerge from the depression that no new activities be added to the Government unless provision is made for additional revenue to meet their cost."

At another point in the same message the President said: "It is pertinent to repeat here a statement appearing in the Summation of the 1936 Budget: 'Estimates of receipts contemplate continued collection of processing taxes. If the attack which has been made upon this Act is sustained, we will have to face the problem of financing existing contracts for benefit payments out of some form of new taxes.'" On the very day that the President's Budget Message was read to the Congress the Supreme Court of the United States rendered a decision holding the Agricultural Adjustment Act unconstitutional. Since that date the Congress has enacted, over the President's veto, the Adjusted Compensation Payment Act of 1936, which requires payment, beginning on June 15th, of the entire amounts, which were to be due in 1945, on the Veterans' adjusted service certificates. The additional cost of making these payments this year, when distributed over the next nine years to the due date of the certificates, comes to approximately \$120,000,000 a year. The Congress has enacted amendments to the Soil Conservation Act which provide for carrying on a continuing program of conservation of the

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Nation's agricultural resources at an estimated cost of approximately \$500,000,000 a year.

Thus to conform to the government's financial program, as set forth in the President's Budget Message, we shall need to provide additional continuing revenue of \$620,000,000 annually to meet these expenditures. We shall also have to find means of recouping approximately \$517,000,000 of revenue sacrificed in the current fiscal year because of the invalidation of the Agricultural Adjustment Act.

The sum of these events means that it is urgently necessary that the Congress provide: First, \$500,000,000 annually of continuing replacement revenue; second, \$120,000,000 of supplemental revenue annually for nine years; third, approximately \$517,000,000 of reimbursement revenue within the next few years to replace the processing taxes lost in this current year.

The President in outlining these needs suggested three sources of revenue which could be made available for the purpose. The first of these suggestions was for processing taxes on agricultural products, at lower rates and distributed over a broader base than the similar taxes under the Agricultural Adjustment Act. The second was a special form of income tax, described as a "windfall" tax, on the unjust enrichment accruing to some corporations and individuals as a result of their escape from the payment of processing taxes. The amount of the

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processing taxes due prior to January 6th, which had thus escaped was approximately \$257,000,000.

The third suggestion, and the one of major importance, was for a revision of our system of corporation taxes. It was proposed by the President that the three existing forms of corporate taxes be repealed. These include the capital stock tax, the excess profits tax, and the corporation income tax. The President proposed that there be substituted for these taxes a tax upon that portion of corporation income which is not distributed to stockholders in dividends and that at the same time the present exemption from the normal income tax of four per cent of dividends received by individuals from corporations be repealed.

I shall deal more fully a little later on with the purposes and merits of these proposals. Just now because of the fact that there has been so much that is inaccurate written and spoken about the origin of these suggestions I would like to speak plainly about the manner in which tax proposals generally are originated and more particularly about the origin of the suggestion of an undistributed earnings tax. It is a fact that I hardly need to stress to the members of this Committee that our tax structure has been frequently changed as new conditions and new needs have arisen and that continuing study is being given to it, not only by the Treasury Department but by the members of this Committee, by the members of the Committee on Ways and Means of the

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House of Representatives and by the experts of the Congress on tax legislation. The need for continuous study constantly arises from the application of new rates, or the effect of changing conditions on the application of old rates; and suggestions for amendment and betterment are constantly being received by the President, by the Committees of the Congress and by the Treasury Department. The study of the tax laws is not a sporadic matter, either in the Congress or the Executive Departments of the Government. The Treasury must constantly maintain a staff of experts whose constant duty is the study of the probably yields and effects of various new and existing forms of taxation.

It was because of this continuing study that, when the need for replacement and supplemental revenues became apparent, as a result of the events that followed the presentation of the President's Budget Message, the Treasury Department was able to supply for the President's consideration the facts on a variety of suggestions for obtaining additional revenues. These alternatives were not limited to the suggestions which the President made in his tax message of March 3rd. They included a number of possible sources of revenue which had been studied in the light of experience with the revenue laws.

Let us refer particularly to the suggestion for an undistributed corporation earnings tax. The notion that this is a novel scheme, new to the Treasury students of taxation and artfully brought forward

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for some obscure purpose, ignores completely longstanding departmental practice and the history and development of income taxation in this country. Actually the proposal is one which has been the subject of study for many years in the Treasury Department and has been discussed and strongly advocated, not only in the revenue committees but on the floor of Congress, on various occasions dated back many years.

The principles incorporated in the present proposal received the attention of the Congress in the earliest period of federal income taxation, the years 1862-1871. At that time Congress provided that the gains and profits of corporations should be included in the annual gains, profit or income of any person entitled to them, whether divided or undivided. That plan would have merits today but there are barriers to giving it effect, which I need not enlarge upon now.

Shortly before and while the revenue act of 1921 was under consideration, a proposal, identical in principle with the President's suggestion, received the widespread attention of representatives of organized business, Members of Congress and the Treasury Department. It was, in fact, presented as a substitute for the corporation tax in the revenue bill then pending, was debated in Committee of the whole of the Senate and was supported generally by the Members of the Minority party and others in a vote of the Committee of the Whole. In a somewhat modified form it was incorporated in a bill passed by the Senate in 1924. A recommendation incorporating this principle was made by Secretary of the Treasury Houston in his Annual Report for the year 1920.

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The status of the President's proposals today is that a bill incorporating two of them has been reported to the House of Representatives by the Committee on Ways and Means. I have no doubt that you will wish to use this proposed bill largely as a basis for your discussions in this Committee; consequently, I shall devote some attention to it.

On a first reading of the Committee's draft of the bill I am impressed by the great amount of thoughtful study and detailed labor that has gone into its preparation. I feel that the Chairman and members of that Committee, for the manner in which they have accomplished an extremely difficult task in a very limited time, deserve unstinted praise. The bill seems to me to be wholly just in the principles which it applies and I hope that these principles and the general outlines of the House bill will be followed in the legislation that is finally enacted. Your Committee will no doubt wish to begin its consideration of the subject by examining the adequacy of the revenues to be expected from the bill as proposed to the House of Representatives in comparison with the President's estimates of the revenues required.

What we are attempting to do, in the light of the President's recommendations, is to redress as nearly as possible the deficiencies in the Budget estimates of revenue caused by the Agricultural Adjustment Act decision and the immediate payment of the bonus. Obviously we can not expect to restore the Budget exactly to the condition it was in before these events occurred. We can not, for instance, restore in this year the revenues that we have lost in this year. We may find it impossible without doing great and unnecessary violence to our revenue

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structure and causing undue hardship, to obtain for the fiscal year 1937 the full amount of revenue necessary: (a) To recoup one-third or more of the \$517,000,000 of processing taxes lost this year; (b) to provide \$120,000,000 for liquidation of the bonus payment; and (c) to raise the \$500,000,000 of revenue needed for agriculture. But it seems to me we should seek to adhere to that program as closely as possible.

The tax bill as reported by the Ways and Means Committee of the House is estimated by the Treasury to yield additional revenue as follows: (a) Net continuing revenue of \$623,000,000 yearly from a tax on corporate earnings, and (b) net temporary revenue of \$180,000,000 from a windfall tax and temporary extension of the capital stock tax.

The temporary revenue to be expected is divided as follows: From the unjust enrichment tax, \$100,000,000; from the temporary extension of the capital stock tax for one year at one half of the present rate, \$80,000,000.

In consequence this bill should fully provide the \$620,000,000 needed to take care of the permanent agricultural program and the annual financing of the payment of the soldiers' bonus. It fully provided for the first year of a three year period for recouping the loss of \$517,000,000 of processing taxes lost during the fiscal year 1936. It does not provide any temporary revenues for the two succeeding years to make up the balance of the \$517,000,000 of temporary revenues desired. This deficiency is approximately \$337,000,000.

The estimated yield of \$623,000,000 from the tax on corporate earnings assumes that this tax has become fully operative. During

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the first year there will be, of course, some lag in the collection of this tax, as is usually true when taxes are shifted from one basis to another. The extent of this lag has been estimated by the Treasury to be \$128,000,000 during the calendar year 1937. Attention has been given to this subject by the Ways and Means Committee and it is my understanding that the bill when passed by the House may contain a provision for bridging this gap.

In considering the adequacy of the revenues to be provided in the legislation which the Congress enacts, we should bear in mind constantly that the President's recommendations were designed solely to restore the national Budget to approximately its position on January 3rd and that the Budget is already out of balance for the fiscal year 1937 with respect to approximately \$2,500 millions of estimated expenditures for relief. Therefore, it seems to me, that this Committee should keep in the foreground that the bill, as reported to the House, is approximately \$337,000,000 short of supplying in the next three years the temporary revenues estimated by the President to be urgently necessary, and should also give earnest consideration to the matter of the lag in additional receipts of permanent revenue affecting receipts for the fiscal year 1937.

I have referred to our obligation to keep faith with investors in Government securities. The President's tax message was sent to the Congress on Tuesday, March 3rd. On Monday, March 2nd, the Treasury made an offering of 12-15 year Treasury bonds at 2-3/4 per cent and 5-year Treasury notes at 1-1/2 per cent interest, the total of the two offerings for cash

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amounting to \$1,250,000,000. The books on the two cash offerings were closed the night of Thursday, March 5th, with the bonds nearly eight times oversubscribed and the notes more than five times oversubscribed. I feel that the President's tax message, which had attracted wide attention during three of the four days while this offering was open to the public, had a very important bearing on the extremely satisfactory result of the financing and that this fact enhances our obligation to find revenues in the amount recommended by the President.

It is to be noted that the bill as reported to the House of Representatives, while failing, according to our estimates, to raise revenues in the full amount sought by the President, utilizes but two of his three suggestions. The third was for the enactment of processing taxes on a broader base but with lower rates than were in effect under the Agricultural Adjustment Act. I call this potential source of additional revenue to your attention again. I feel sure that the Secretary of Agriculture stands ready to supply any information you may desire on this subject which has been gathered in his experience with the application of a similar tax.

I shall pass on now to the consideration of the two suggestions by the President that were embodied in the House bill. As to the proposed windfall tax, I think there is little that need be said. I have not heard the justice of this tax very seriously questioned. There is no doubt whatever that the invalidation of the Agricultural Adjustment Act, coupled with the withholding of processing taxes accrued prior to January 5th,

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has resulted in unjust enrichment of a limited number of persons and corporations. It would be grossly unfair to the persons and corporations who paid their processing taxes as due up to the time of the Supreme Court's decision and it would be unfair to the American consumer, who ultimately bore the burden of the taxes, not to reduce this unjust enrichment as much as we can by taxation.

I take it for granted that a windfall tax, whether on the exact terms laid down in the bill pending before the House or under some other formulation, will be enacted by the Congress. I assume, too, that you will give most serious consideration to the matter of the deficiency in the expected revenue from the House Bill as compared with the President's estimates of the need. I turn, therefore, to the most important feature of the House proposals embodying the President's suggestions, the proposed tax on corporate income, and shall consider it from the standpoint of the Ways and Means Committee bill, and in the light of objections that have been raised against the whole proposal.

The principle of taxation according to ability to pay is now well established, not merely by having been written by amendment into the Constitution of the United States and supported by twenty years of application in our tax structure, but by undoubted and unquestioned endorsement and support by the citizens of this Nation. Through successive changes in our tax laws, however, we have departed most seriously from a consistent and just application of the principle. We apply the principle to individual incomes, whether they are obtained from interest, rents, or salaries, from

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the profits of individual business enterprise or from partnership undertakings. We do not apply it to profits gained from corporate enterprise, except in a manner which taxes some citizens at unfairly high rates and gives to others the opportunity to avoid taxation on a wholesale scale. We apply penalties to the use of the corporate form of doing business, which tax inequitably those corporations which are making approximately full distribution of their earnings and which tax their stockholders at disproportionately heavy rates, but, at the same time, we open a wide door of escape and avoidance of federal income taxation for those who are in the position to make use of it. This door of escape leads to double advantage to men of large incomes doing business through corporations.

The first special advantage it yields to them is that, through withholding earnings, and paying them out only as those in control elect, a corporation is able to average the earnings and the losses of its stockholders over an indefinite period of years. The individual does not have this opportunity. If he had a large income in 1929, for instance, he paid in 1930 a tax based exactly on that 1929 income, in whatever brackets of taxation it might fall. If he suffered heavy losses in 1930 and 1931, he was not able to make any deduction or obtain any refund of the taxes he had already paid and for which he had already become liable on his 1929 income. If that same individual's activities had been incorporated, he need have paid individual income taxes only on that portion of his earnings that he withdrew in the form of salary and dividends during the good

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year to meet his current needs, and by withholding the remainder he would have been able to offset the losses that he sustained in the two succeeding years. That is one door of escape, and it is a most important one.

The second avenue of avoidance is in realization of so-called capital gains. By withholding earnings from distribution, a corporation builds up enhanced capital values which are reflected in the worth of its stock. After a block of that stock has been held in the original ownership for a number of years, it can be sold and the resulting gains in value will be taxed at lower rates than other sources of income. As an instance, if the stock has been held for ten years and then sold only 30% of the resulting gain from its sale will be taxed as income, and if the individual's surtax rates have thus been brought as high as a bracket of 50% he will pay a tax equal to only 15% of the whole amount of his gain.

But there is a very great number of instances in which corporate earnings have continued to pile up year after year for a far longer period than ten years, constantly adding to the estates of their individual owners, without ever having been subject to any surtax taxation, but only to the present corporation income taxes at rates never higher than 15%. What this means in simple terms is the privilege of reinvesting earnings without the payment of surtaxes upon them, a privilege of very great monetary value to those whose incomes reach surtax brackets higher than 15%. This means anyone whose income is more than \$22,000 a year. What are the dimensions of tax avoidance with which we are dealing? A few simple figures tell the story. It has been estimated by the actuaries of the Treasury Department that under the present tax law the income tax liability of corporations on the basis of 1936 earnings would approximate 964 millions.

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The same actuaries have estimated that during the calendar year 1936 more than four and one-half billion dollars of corporation income will be withheld from stockholders and that if this income were fully distributed to the individual owners of the stock represented in these corporations, the resultant yield in additional individual income taxes would be about one and one-half billions, fifteen hundred millions of dollars to be added to revenue from taxes on individual incomes, as against 964 millions that would be yielded by our present form of taxation of corporation income.

Now, the President has suggested that the Congress enact a tax measure which will produce approximately the same revenue from corporate earnings, whether they are distributed or not distributed. He suggested also repeal of the present corporation <sup>income</sup> tax, the capital stock tax, the excess profits tax, and repeal of the exemption from the 4 percent normal income tax of dividends distributed by corporations; all these taxes to be replaced by a single tax on undistributed corporate earnings.

Whatever may be the debatable considerations that may enter into the preparation of particular schedules, it will be well to bear in mind at all times that this is purely and simply a proposal to put all taxes on business profits essentially on the same equitable basis; to give no advantages and to impose no penalties upon corporations for the corporate form of individual investment that are not given to and imposed upon the individual taxpayer who alone or as a partner derives his income from business profits. It seeks to remove disadvantages now suffered by the individual who does not own corporation stock, by the small stockholder, whether in a large corporation or a small corporation, by the

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stockholder in a corporation which makes full distribution of its earnings as compared to the stockholder in a corporation which distributes only a small fraction of its earnings, and by corporations which distribute generously as compared to corporations which withhold a major part of earnings from distribution. The Committee on Ways and Means has applied the principle suggested by the President in a form which expresses the tax not as a levy upon that portion of corporate income which is not distributed in the form of dividends to stockholders, but as a levy on total income. The Committee has adopted schedules which apply to the entire adjusted net income of a corporation, at rates graduated according to the portion of the income which is retained by the corporation after the distribution of dividends and after the payment of tax. It apparently has been thought by the House Committee that this form of expression of the tax rates will more clearly represent to the corporation stockholder the tax cost of retaining any given proportion of net earnings for capital purposes.

Probably the first thing to be noticed about the rates as proposed in the bill introduced in the House, is that any corporation that distributes all of its current earnings will pay no Federal corporation taxes whatever. Such tax as applies will be paid by the individual stockholders on the same basis as all other individual income taxes are paid. But let us see what will occur in the case of corporations which do not distribute their earnings fully. Two sets of rates have been presented by the House Committee, one applying to corporations with

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adjusted net incomes of \$10,000 or less; the second applying to corporations with adjusted net incomes of more than \$10,000, with a provision for merging the effect of these schedules on corporations with adjusted net incomes between \$10,000 and \$40,000. The small income corporations, represented in the first class, will be able to retain up to 40 percent of a year's earnings for capital purposes and still pay less tax than they pay now. Corporations with large incomes will be enabled to retain 30 percent without paying as much in taxes as are paid under the present law.

Let us consider a few particular examples. Here is a large manufacturing corporation, with net earnings before Federal taxes of \$25,000,000. If we assume that the declared value of the capital stock of this corporation is ten times its net earnings, or \$250,000,000, we find that the corporation under the present law would pay the following taxes to the Federal Government: Capital stock tax at \$1.40 per thousand, \$350,000; corporation income tax (at bracket rates up to 15 percent), \$3,696,940; a total of \$4,046,940. Under the proposed plan, this corporation would pay no taxes at all if it paid out all of its earnings in dividends. If it should decide to retain for contingency reserves, or to add to its surplus, 20 percent of its annual earnings, corporation taxes under the proposed plan would amount to \$2,250,000, slightly more than half of its present Federal taxes. If the corporation elected to retain 30 percent of current earnings, the tax would be \$3,750,000 or \$296,940 less than would be paid under the present law. It should be borne in mind in this connection that legitimate reserves

withheld out of gross earnings for depreciation and depletion are deducted from gross income before determining adjusted net income and that these increments to operating reserves would be free from taxation as they are now.

As a second instance let us take the case of a merchant in a small city who has chosen the corporate form of doing business, who has an invested capital of \$20,000, but who in order to minimize his excess profits tax files a declared value of his capital stock as \$40,000. This merchant's corporation reports earnings, before federal taxes but after all salaries and allowance for depreciation, of \$5,000. Under the present law this corporation would pay the following taxes to the federal Government: Capital stock tax at \$1.40 per thousand, \$56; excess profits tax, \$56.64; corporation income tax, \$532.72, a total of \$745.36. Under the proposed plan the corporation, owned, let us say, by this merchant and his family, would pay no federal corporation taxes whatever if it paid out all of its earnings in dividends. If it were to withhold from distribution and reinvest in the business an amount equal to 40 percent of its year's earnings, the total federal corporation taxes, under the proposed plan, would be \$650 or \$95.36 less than all the taxes under the present law.

Let us take as a third example a corporation whose principal asset is an apartment house, built in 1928 at a cost for land and buildings of \$200,000. The property is subject to a first mortgage of \$100,000, which secures the corporation's six percent bonds of like amount. The stockholders of the corporation had hoped to realize a net return of 10 percent annually, or \$20,000 on the invested capital of \$200,000. After paying

\$6,000 of bond interest they hoped to have left \$14,000, which would yield them a return of 14 percent on their investment of \$100,000. To avoid paying an excess profits tax they reported a declared value of \$140,000 for their capital stock. At present, however, the net return on the total investment is only \$10,000, out of which the corporation must pay \$6,000 bond interest, leaving net profits of \$4,000 per annum. The mortgage indenture calls for the retirement each year of \$4,000, principal amount of bonds. However, in computing its income for tax purposes the corporation has naturally deducted a depreciation allowance of 2 percent on the total investment. The corporation, therefore, in addition to its \$4,000 of net earnings has an additional \$4,000 available for bond retirement from its depreciation reserve. Under the existing law this corporation pays the following taxes to the federal Government: Capital stock tax, \$196; corporation income tax, \$484.52; a total of \$680.52. Under the proposed plan this corporation would pay no federal taxes whatever if all of its earnings were distributed in dividends. Further, if the owners of the corporation desired to retire an additional \$4,000 of bonds with these earnings, they would find it profitable to pay out such earnings to themselves as stockholders and then to acquire the bonds as individuals, thereafter, if they desired, turning in the bonds to the corporation in exchange for additional stock. If these steps were taken the corporation would pay no federal taxes whatever as compared with the present federal taxes of \$680.52.

As a fourth example take the case of a railroad, capitalized at \$300,000,000, of which \$150,000,000 is represented by first mortgage  $4\frac{1}{2}$  percent bonds and the other \$150,000,000 by preferred and common stocks. This railroad and its subsidiaries take advantage of the privilege under the present law of filing a consolidated return, under which they are subject to the corporation income tax rate of  $15\text{-}\frac{3}{4}$  percent. The consolidated net earnings, after depreciation charges but before interest, amount to only  $3\text{-}\frac{1}{3}$  percent on the total invested capital of \$10,000,000. Interest charges absorb \$6,750,000, leaving \$3,250,000 available for the preferred and common stocks. Because the railroad does not expect to be permitted by public regulatory bodies to earn more than 7 percent on its total invested capital, it declares the value of its capital stock to be \$142,500,000, instead of \$150,000,000 or some higher figure. Under the present law the railroad corporation would pay the following taxes to the federal Government: Capital stock tax, \$199,500; corporation income tax, \$480,453.75, a total of \$679,953.75. Under the proposed plan this railroad would pay no federal tax whatever if it paid out all of its earnings in dividends. Indeed if it employed as much as \$1,000,000 of its earnings for retirement of debt, its aggregate federal taxes under the proposed plan would be only \$512,500 as contrasted with \$679,953.75 that it would pay under the present law.

Examples might be multiplied of the effect of the proposed tax bill upon existing corporations, small or great. In all instances it will be found that earnings under the proposed plan may be reinvested in the business, without distribution, in substantial and liberal amounts without increase in the corporate tax burden and in most instances with a marked reduction. It is true that in many cases stockholders will pay larger taxes on individual incomes as their incomes are increased by dividend distributions, but they will pay no more than others now pay on business profits.

It has been said, however, that the proposal would penalize small and growing businesses as compared to corporations which, through the accumulation of earnings and their reinvestment under the present tax system, have placed themselves in an impregnable competitive position. In essence this argument is that since the federal Government has in effect for many years been subsidizing the concentration of capital in large corporation aggregations and has been subsidizing in effect the building up of huge personal fortunes, it should not deprive the ambitious and aggressive members of the new generation of the same unfair privilege. But the difficulties of building up new businesses on a great scale and of building new fortunes under the proposed tax plan have been greatly magnified. We have seen how the small corporation can withhold and pass to surplus up to 40 percent of earnings without paying heavier corporate taxes than at present. Forty percent annually is a fairly respectable rate of growth. In ten years it amounts to 400 percent of a typical year's earnings.

Further, if we are considering the needs and opportunities of the business and not merely the purpose of avoiding taxation, it would seem that a good share of corporations whose earnings and opportunities justify expansion would be able to obtain new capital by persuading their stockholders to reinvest their dividends, or a substantial part of them, particularly if it happened, as so often happens in the case of small and growing corporations, that stockholders representing a majority interest in the corporation are themselves drawing salaries from the corporation which are deductible in computing its net income.

Those who foresee difficulties for the small corporation in the proposed legislation can not have analyzed closely the schedules incorporated in the House Bill, nor even the existing individual income tax schedules. The individual stockholders of a small corporation, all of whose earnings were distributed in dividends, would have to possess individual taxable incomes of approximately \$30,000 or more on the average to be subject to as much taxation on their additional income under the House Bill as their corporations are under the present law.

Corporate growth and prosperity depend upon many factors of which the tax burden is only one. It seems clear that under existing law new and small corporations are at a disadvantage in their efforts to grow to competitive size and strength with large corporations. Our tax law has, as we have seen, favored and in fact subsidized the development of huge aggregations of capital and of corporate power. It continues to favor them, and will continue to favor them, so long as the present situation exists and thus renders increasingly more difficult, year by year, the development

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of effective competition with them.

We have heard it said that, if the proposed bill should result in a much larger distribution of corporate earnings and of dividends, so far as this goes to individuals of already large incomes it will simply drive them into investment in tax-exempt securities and thus the Government will not get the revenue that the Treasury anticipates from the new measure. Let us take a look at that argument. It has several aspects. In the first place refuge from taxes by means of tax exempt securities is very definitely limited by the amount of tax exempt securities available and the rates of interest that they pay.

The largest source of tax-exempt income is that derived from the obligations of states, counties, cities, etc. The net aggregate amount of such tax-exempt securities has not changed materially during the past five years. On June 30, 1931 the net principal amount outstanding, as estimated in the 1935 Annual Report of the Secretary of the Treasury, was approximately 17.5 billions of dollars and on June 30, 1935 approximately 16.9 billions of dollars. In other words, between these two dates a decrease has actually taken place in the net principal amount of tax-exempt state, county and municipal obligations. The issue of such obligations appears to have entered into a declining cyclical phase. Many local governments have either reached, or are approaching <sup>the</sup> a constitutional or statutory limitations upon their indebtedness and it is likely that they will find it increasingly difficult to issue additional tax-exempt securities in the volume that they had been doing during the twenties.

The federal Government is not issuing any fully tax-exempt bonds. In fact during the present Administration the First Liberty Loan bonds and certain other pre-war bond issues that were exempt from surtaxes, have been refunded, in part by bonds lacking the surtax exemption privilege. The only fully tax-exempt obligations that the federal Government is issuing are short-term bills and notes. The tax-exempt income made available by these issues, however, is far less than their principal amount would suggest. The Treasury has been borrowing at a cost of one-eighth of one per cent per annum on Treasury bills of six or nine months maturity and at 1-1/2 to 1-5/8 per cent per annum on five-year notes. Moreover, much the greater part of the Treasury's bill and note issues are purchased by financial and other corporations which derive no benefit from the fact that the interest on these short-term securities is exempt from surtaxes, since corporations are not subject to surtaxes in any event; that is, whereas the interest on the short-term Treasury notes held by an individual might be exempted from a surtax bracket rate as high as seventy or seventy-five per cent, in the hands of a corporation the exemption is limited to the rate of the corporation income tax, the maximum of which is 15-3/4 per cent in the case of consolidated railroad returns. Further, the tax exemption that corporations enjoy on the income derived from federal obligations does not apply to the dividends based upon this tax-exempt income when the latter is distributed to stockholders.

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I would like to emphasize again that it is tax-exempt income rather than the principal amount of tax-exempt securities that is important. And I would like to point out in this connection that the declining trend of interest rates on state, county and municipal debts, as well as on federal obligations, is operating very powerfully to reduce the amount of tax-exempt income. If we assume for example that the average rate of interest on state and municipal bonds now outstanding amounts to  $4\frac{1}{2}$  per cent, a reduction of only one-half of one per cent in the average coupon rate, is roughly equivalent to a reduction of two billion dollars in the principal amount of the tax-exempt debt outstanding, so far as tax-exempt income is concerned, as against the present average coupon rate of about  $4\frac{1}{2}$  per cent on the outstanding state and municipal obligations. It is striking to note that the interest rates on ten typical new offerings of state and municipal bonds during the first three months of 1936, as listed in the appended table, run from only  $2\frac{1}{4}$  to 4 per cent. If the present trend of interest rates continues, or even if only the present level is maintained, we can reasonably expect a reduction in the total amount of tax-exempt income as a result of the refunding of state and municipal obligations on a lower interest basis.

A greater distribution of tax exempt securities will not create a new situation, so far as investment in tax-exempt securities is concerned. The existing individual income tax rates have already fostered a considerable concentration of tax-exempt securities in the hands of

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individuals subject to high surtaxes and it should be borne in mind that a further loss of revenue to the federal Government from this source could only be caused by a transfer of such securities from individuals and institutions subject to relatively low surtax rates to those in higher surtax brackets. The practical possibilities for such further transfers are not unlimited both because of the existing concentration and because a large volume of institutional holdings of tax-exempts will be retained for legal and other reasons.

There is still another objection that has been advanced to the new corporation tax proposal. Admitting all the inequities of the present system, admitting that through it the federal Government is in effect subsidizing concentration of capital, it is nevertheless argued that this method of tax avoidance, this big leak in our tax system which rewards and subsidizes at the public's expense the big investor in the big corporation at the expense of the small investor in the small corporation and the general public, is to be defended on the grounds of public policy since it results in building up in private hands a sort of insurance fund against depressions. Now the most

obvious fact bearing on this argument is that whatever its theoretical merits may be, the simple truth is that it did not work. Surely the system had been operating long enough for its effects, beneficial or otherwise, to have been realized when in 1929 the greatest depression which this country has ever experienced came upon us. We know that our tax system did not prevent the depression because we know we have experienced a depression, but if we examine the matter we may find some reason for believing that the corporate tax system actually assisted in causing the depression. Thus it has been argued by very respectable economic authority that among the causes of the depression was starving of consumption through the withdrawal of a too large proportion of our funds for capital expenditure. Is it not quite possible that in many instances, important in the aggregate, over-expansion of plant capacity was stimulated by the desire of controlling stockholders in corporations to reinvest earnings for the purpose of avoiding the taxation that would have resulted from their distribution? It has been said also that one of the malign influences causing the great stock market booms of the late twenties was the availability of the surplus funds of business corporations, which poured into the stock market, to stimulate brokers' loans and mad stock speculations that had already been over-stimulated by the piling up of corporate surpluses, which seemed to place their owner corporations in such a strong position that their dividend records and even their current earnings records might be disregarded in assaying the value of their stock.

But, we have been at pains to examine the matter a little further on the basis of the data we have had available in the Treasury Department.

Large figures are frequently cited to represent the aggregate losses of American corporations during the depression from which we are now emerging. Either by direct statement or by implication, the contention is made that these losses represent the amounts which corporations have had to pay out, in excess of their receipts, to workers, bondholders, suppliers of materials, and the like; and that only their previously accumulated surpluses allowed them to do this without bankruptcy.

The figures reported each year to the Bureau of Internal Revenue are strikingly at variance with this contention or belief. Let me cite you some of the facts that I shall present in greater detail in tables attached to this statement:

First: If we consolidate the income accounts of all corporations for each of the three years 1931-1933, inclusive, we find that corporations reported an aggregate net deficit for this three-year period, after taxes, of \$6.6 billions. We also find, however, that this aggregate net deficit was arrived at after deducting some \$11.2 billions for depreciation, some \$3.7 billions for bad debts, some \$761 millions for depletion, and some \$5.1 billions for loss on the sale of capital assets; deductions which in the main do not represent current cash outlays. In other words, the net income of corporations before these valuation deductions, in the worst depression in history, was a little more than \$14 billions, and their cash dividends a little more than \$13 billions.

For corporations as a whole, dividends, wages and other payments

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came out of current receipts, and still left about \$1 billion of these current receipts to spare. In the aggregate, there was no drawing down of accumulated surplus for wage payments, purchase of materials, and other cash outgoes. The book surpluses were, indeed, reduced, but they were reduced, in the aggregate, not by actual cash disbursements, but by the writing down of assets.

It may well be objected that these figures may be deceptive because they include financial as well as non-financial corporations. But the figures for non-financial corporations alone, which include all of our manufacturing, mining, merchandising and other business corporations, tell substantially the same story. Non-financial corporations reported a net aggregate deficit after taxes for the three years 1931-1933, inclusive, of \$5.9 billions. Their net income before valuation deductions, however, amounted to \$11.1 billions and their dividends paid to \$10.6 billions. It is obvious that the previously accumulated surpluses of non-financial corporations, while reduced by valuation deductions, were not drawn upon, in the aggregate, to pay wages or dividends. The cash and investments of all non-financial corporations submitting balance sheets amounted to \$32.7 billions at the end of 1929; at the end of 1933 they amounted to \$33.5 billions.

Even if we confine our attention to deficit non-financial corporations, that is, non-financial corporations reporting no statutory net income, we find that valuation deductions, rather than cash outlays, accounted for the largest part of their aggregate net losses during the depression. During

the three years 1931-1933, inclusive, the aggregate net losses after taxes of those non-financial corporations that reported no net income amounted to \$12.1 billions; but \$9.5 billions of this aggregate deficit, or 78 per cent, represented valuation deductions primarily rather than cash disbursements in excess of cash receipts.

It should be borne in mind, moreover, that a corporation is included in the deficit group only in those years in which it reports no net income; so that the figures that I have just cited include the losses of all corporations during their worst years of the depression, and do not include their net incomes, if any, in other years of the depression.

There were, it is true, other deductions in the book surpluses of corporations besides those allowed for income tax purposes. Most corporations are permitted to exercise a liberal range of discretion in the valuation of their assets on their own books and for their own purposes. Just as many of them revalue their assets upward during periods of prosperity, thereby creating direct additions to their surplus independently of their income accounts, so, in periods of depression many corporations make large write-downs in the valuation of their assets on their own books and they make corresponding reductions in their book surplus accounts. It must be emphasized, however, in contradiction to certain misleading statements that have gained considerable currency, that reductions in book surpluses arising in this fashion do not represent funds paid out to employ labor, to purchase materials, or to pay interest or dividends.

In general, then, the figures reported to the Bureau of Internal

Revenue clearly indicate, first, that valuation deductions, rather than net cash outlays, account for the largest part of the losses reported even by deficit corporations; second, that for corporations as a whole these valuation deductions greatly exceeded the aggregate net losses reported during the depression; and, third, that corporate surpluses in the aggregate have not been drawn down in fact to maintain employment, interest payments, and other disbursements during the depression.

In closing let me say this. I sincerely hope that this Committee will report to the Senate a bill giving effect, as fully as possible, to the President's recommendations of the amount of additional revenue needed to supply the deficiencies created since the Budget Message of January 3rd. I sincerely hope that this bill will follow the line of the President's suggestions; in particular, that it will accomplish a system of reform of our system of corporation taxes that the President has outlined, that it seems to me is demanded not only in the interest of improving the revenue structure, but of doing justice and equity as between citizens.

*Draft only  
to Russell  
Apr. 27  
changed to  
Apr 30*

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Statement of Secretary Morgenthau before the  
Senate Finance Committee,

I welcome the opportunity to appear and discuss with you the tax proposals contained in the President's message to the Congress of March 3rd, and to present the Treasury's viewpoint.

As Secretary of the Treasury, I feel a special responsibility to do all in my power to maintain the integrity of the President's Budget of January 3, 1936; and therefore to urge that the supplemental revenues made necessary by the developments of the past few months be provided.

The Treasury fortunately has been able to borrow readily the amounts necessary to finance the recovery program and has been able to obtain these loans at steadily decreasing interest rates. The continuance of this satisfactory situation, however, will depend upon scrupulous

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adherence to an orderly program looking to a balance of the Federal budget just as soon as the needs and abilities of our people make that possible and thereafter upon a steady reduction in the public debt.

In his Budget Message of January 3, 1936, the President made this statement: "If the Congress enacts legislation at the coming session which will impose additional charges upon the Treasury, for which provision is not already made in this Budget, I strongly urge that additional taxes be provided to cover such charges. It is important as we emerge from the depression that no new activities be added to the Government unless provision is made for additional revenue to meet their cost."

At another point in the same message the President said: "It is pertinent to repeat here a statement appearing in the Summation of the 1936 Budget: 'Estimates of receipts

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contemplate continued collection of processing taxes. If the attack which has been made upon this Act is sustained, we will have to face the problem of financing existing contracts for benefit payments out of some form of new taxes."

On the very day that the President's Budget Message was read to the Congress the Supreme Court of the United States rendered a decision holding the Agricultural Adjustment Act unconstitutional. Since that date the Congress has enacted, over the President's veto, the Adjusted Compensation Payment Act of 1936, which requires payment, beginning on June 15th, of the entire amounts, which were to be due in 1945, on the veterans' adjusted service certificates. The additional cost of making these payments this year, when distributed over the next nine years to the due date of the certificates, comes to approximately

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\$120,000,000 a year. The Congress has enacted amendments to the Soil Conservation Act which provide for carrying on a continuing program of conservation of the Nation's agricultural resources at an estimated cost of approximately \$500,000,000 a year.

Thus to conform to the Government's financial program, as set forth in the President's Budget Message, we shall need to provide additional continuing revenue of \$620,000,000 annually to meet these expenditures. We shall also have to find means of recouping approximately \$517,000,000 of revenue sacrificed in the current fiscal year because of the invalidation of the Agricultural Adjustment Act.

The President in outlining these needs suggested three sources of revenue which could be made available for the purpose. One of these suggestions was for processing

taxes on agricultural products, at lower rates and distributed over a broader base than the similar taxes under the Agricultural Adjustment Act. Another was for a special form of income tax, described as a "windfall" tax, on the unjust enrichment accruing to some corporations and individuals as a result of their escape from the payment of processing taxes. The amount of the processing taxes due prior to January 6th, which had thus escaped was approximately \$237,000,000.

The third suggestion, and the one of major importance, was for a revision of our system of corporation taxes. It was proposed by the President that the three existing forms of corporate taxes be repealed. These include the capital stock tax, the excess profits tax, and the corporation income tax. The President proposed that there be substituted for these taxes a tax upon that

portion of corporation income which is not distributed to stockholders in dividends and that at the same time the present exemption from the normal income tax of four per cent of dividends received by individuals from corporations be repealed.

The status of the President's proposals today is that a bill incorporating two of them has been reported to the House of Representatives by the Committee on Ways and Means. I have no doubt that you will wish to use this proposed bill largely as a basis for your discussions in this Committee.

On a first reading of the Committee's draft of the bill I am impressed by the great amount of thoughtful study and detailed labor that has gone into its preparation. I feel that the Chairman and members of that Committee deserved unstinted praise for the excellent manner in which

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they have accomplished their important task. Your Committee will no doubt wish to begin its consideration of the subject by examining the adequacy of the revenues to be expected from the bill as proposed to the House of Representatives in comparison with the President's estimates of the revenues required.

The tax bill as reported by the Ways and Means Committee of the House is estimated by the Treasury to yield additional revenue as follows: (a) Net continuing revenue of \$623,000,000 yearly from a tax on corporate earnings, and (b) net temporary revenue of \$180,000,000 from an unjust enrichment tax and temporary extension of the capital stock tax, divided as follows: From the unjust enrichment tax, \$100,000,000; from the extension of the capital stock tax for one year at one-half of the present rate, \$80,000,000.

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The bill thus fully provides the \$620,000,000 needed to take care of the permanent agricultural program and the annual financing of the payment of the soldiers' bonus. It also provides for the first year of a three-year period for recouping the loss of \$517,000,000 of processing taxes lost during the fiscal year 1936. However, it does not provide any temporary revenues for the two succeeding years to make up the balance of \$337,000,000 of temporary revenues desired.

The estimated yield of \$623,000,000 from the tax on corporate earnings assumes that this tax has become fully operative. It is the estimated amount of additional revenue to be derived from the application of the rates and schedules in the House bill to corporate earnings for the present calendar year, 1936. It must be recognized that the choice of an income tax as the means for raising

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additional revenue necessarily involves a delay in realization of increased receipts. Receipts from taxes on corporate incomes for the calendar year 1936 will be collected in the main during the calendar year 1937 and will be divided between the two fiscal years, the fiscal year 1937, ending June 30, 1937, and the fiscal year 1938. A further lag in collections would result from a provision in the Ways and Means Committee bill which would permit corporations in computing the tax on undistributed earnings for any calendar year to take credit for dividends distributed between January 1st and March 15th of the following year, while these dividends would not be taxable against the individual until the succeeding year. Attention has been given to this matter by the Ways and Means Committee and I am informed that an amendment containing provision for bridging this gap will be offered in the House. Assuming

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that this delay in collections is to be removed, the net additional revenue to be expected from the application of the undistributed corporate profits tax is estimated to be \$343,000,000 in the fiscal year 1937. The full additional annual revenue would be collected in the fiscal year 1938.

It is to be noted that the bill as reported to the House of Representatives, while failing, according to our estimates, to raise temporary revenues for a three-year period in the full amount sought by the President, utilizes but two of his three suggestions. The third was for the enactment of processing taxes on a broader base but with lower rates than were in effect under the Agricultural Adjustment Act. I call this potential source of additional revenue to your attention again. I feel sure that the Secretary of Agriculture stands ready to supply any information you may desire on this subject.

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I shall pass on now to the consideration of the two suggestions by the President that were embodied in the House bill. As to the proposed unjust enrichment tax, I think there is little that need be said. I have not heard the justice of this tax very seriously questioned. There is no doubt whatever that the invalidation of the Agricultural Adjustment Act, coupled with the withholding of processing taxes accrued prior to January 6th, has resulted in unjust gains to a limited number of persons and corporations. It would be grossly unfair to the persons and corporations who paid their processing taxes as due up to the time of the Supreme Court's decision and it would be unfair to the American consumer, who ultimately bore the burden of the taxes, not to reduce this unjust enrichment as much as we can by taxation.

I take it for granted that an unjust enrichment or "windfall" tax will be enacted by the Congress. I

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assume, too, that you will give most serious consideration to the matter of the deficiency in the temporary revenue for a three-year period expected from the House bill as compared with the President's estimates of the need. I turn, therefore, to the most important feature of the House proposals embodying the President's suggestions, the proposed tax on corporate income.

The principle of taxation according to ability to pay is now well established, not merely by having been written by amendment into the Constitution of the United States and supported by twenty years of application in our tax structure, but by the undoubted and unquestioned endorsement and support of the citizens of this Nation. Through successive changes in our tax laws, however, we have departed most seriously from a consistent and just application of the principle. We apply the principle to

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individual incomes, whether they are obtained from interest, rents, or salaries, from the profits of individual business enterprise or from partnership undertakings. We do not apply it to profits gained from corporate enterprise, except in a manner which taxes some citizens at unfairly high rates and gives to others the opportunity to avoid taxation on a wholesale scale. We apply penalties to the use of the corporate form of doing business, which tax inequitably those corporations which are making approximately full distribution of their earnings and which tax their stockholders at disproportionately heavy rates, but, at the same time, we open a wide door of escape and avoidance of Federal income taxation for those who are in the position to make use of it.

What are the dimensions of tax avoidance with which

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we are dealing? A few simple figures tell the story. It has been estimated by the actuaries of the Treasury Department that under the present tax law the income tax liability of corporations on the basis of 1936 earnings would approximate 964 millions. The same actuaries have estimated that under the present law more than four and one-half billion dollars of corporation income in the calendar year 1936 will be withheld from stockholders and that if this income were fully distributed to the individual owners of the stock represented in these corporations, the resultant yield in additional income taxes would be about one and one-half billions.

It can not be assumed that under the operations of the present corporation taxes there will be any substantial change in the policies of corporations with respect to the distribution of dividends. Consequently the new basis of

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taxation of corporation profits has been embodied in the bill now before the House of Representatives.

With tax avoidance occurring on the scale indicated by the figures I have cited, I do not see how any increase in individual income tax rates or other general and continuing taxation could be justified until this leak in our tax system is stopped.

Whatever may be the debatable considerations that may enter into the preparation of particular schedules, it will be well to bear in mind at all times that this is purely and simply a proposal to put all taxes on business profits essentially on the same equitable basis; to give no advantages and to impose no penalties upon corporation stockholders that are not given to and imposed upon the individual taxpayer who alone or as a partner derives his income from business profits.

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In closing let me say this. I sincerely hope that this Committee will report to the Senate a bill giving effect, as fully as possible, to the President's recommendations of the amount of additional revenue needed to supply the deficiencies created since the Budget Message of January 3rd.

--oOo--

As Secretary of the Treasury, I feel a divided responsibility to do all in my power to maintain the integrity of the President's Budget of January 3, 1950, and therefore to urge that the supplemental revenues made necessary by the developments of the past few months be provided.

The Treasury has been able to borrow readily the amounts necessary to finance the recovery program and has been able to obtain these resources readily

Statement of Secretary Morgenthau before the  
Senate Finance Committee, Thursday, April 30, 1936.

I welcome the opportunity to appear and discuss with you the tax proposals contained in the President's message to the Congress of March 3rd, and to present the Treasury's viewpoint.

As Secretary of the Treasury, I feel a special responsibility to do all in my power to maintain the integrity of the President's Budget of January 3, 1936; and therefore to urge that the supplemental revenues made necessary by the developments of the past few months be provided.

The Treasury has been able to borrow readily the amounts necessary to finance the recovery program and has been able to obtain these loans at steadily

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decreasing interest rates. The continuance of this satisfactory situation, however, will depend upon scrupulous adherence to an orderly program looking to a balance of the Federal budget just as soon as the needs and abilities of our people make that possible and thereafter upon a steady reduction in the public debt.

In his Budget Message of January 3, 1936, the President made this statement: "If the Congress enacts legislation at the coming session which will impose additional charges upon the Treasury, for which provision is not already made in this Budget, I strongly urge that additional taxes be provided to cover such charges. It is important as we emerge from the depression that no new activities be added to the Government unless provision is made for additional revenue to meet their cost."

At another point in the same message the President

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said: "It is pertinent to repeat here a statement appearing in the Summation of the 1936 Budget: 'Estimates of receipts contemplate continued collection of processing taxes. If the attack which has been made upon this Act is sustained, we will have to face the problem of financing existing contracts for benefit payments out of some form of new taxes.'"

On the very day that the President's Budget Message was read to the Congress the Supreme Court of the United States rendered a decision holding the Agricultural Adjustment Act unconstitutional. Since that date the Congress has enacted, over the President's veto, the Adjusted Compensation Payment Act of 1936, which requires payment, beginning on June 15th, of the entire amounts, which were to be due in 1945 and thereafter, on the veterans' adjusted service certifi-

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cates. The additional cost of making these payments this year, when distributed over the next nine years, comes to approximately \$120,000,000 a year. The Congress has provided for carrying on a continuing program of conservation of the Nation's agricultural resources which will result in expenditures of approximately \$500,000,000 a year.

Thus to conform to the Government's financial program, as set forth in the President's Budget Message, we shall need to provide additional continuing revenue of \$620,000,000 annually to meet these expenditures. We shall also have to find means of recouping approximately \$517,000,000 of revenue sacrificed in the current fiscal year because of the invalidation of the Agricultural Adjustment Act.

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The President in outlining these needs suggested three sources of revenue which could be made available for the purpose. One of these suggestions was for processing taxes on agricultural products, at lower rates and distributed over a broader base than the similar taxes under the Agricultural Adjustment Act. Another was for a special form of income tax, described as a "windfall" tax, on the unjust enrichment accruing to some corporations and individuals as a result of their escape from the payment of processing taxes. The amount of the processing taxes due prior to January 6th, which had thus escaped was approximately \$237,000,000.

The third suggestion, and the one of major importance, was for a revision of our system of corporation taxes. It was proposed by the President that the three existing forms of corporate taxes be repealed. These

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include the capital stock tax, the excess profits tax, and the corporation income tax. The President proposed that there be substituted for these taxes a tax upon that portion of corporation income which is not currently distributed to stockholders in dividends and that at the same time the present exemption from the normal income tax of four per cent of dividends received by individuals from corporations be repealed.

The status of the President's proposals today is that the House has passed a bill to give effect to two of them. The House bill is estimated by the Treasury to yield additional revenue as follows: (a) Net continuing revenue of \$623,000,000 yearly from a tax on corporate earnings, and (b) net temporary revenue of \$180,000,000 from an unjust enrichment tax and temporary extension of the capital stock tax, divided

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as follows: From the unjust enrichment tax, \$100,000,000; from the extension of the capital stock tax for one year at one-half of the present rate, \$80,000,000.

The bill thus fully provides the \$620,000,000 needed to take care of the permanent agricultural program and the annual financing of the payment of the soldiers' bonus. It also provides for the first year of a three-year program for recouping the loss of \$517,000,000 of processing taxes lost during the fiscal year 1936. However, it does not provide any temporary revenues for the two succeeding years to make up the balance of \$337,000,000 of temporary revenues desired.

The estimated yield of \$623,000,000 from the tax on corporate earnings is the amount of additional revenue to be derived from the application of the rates

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and schedules in the House bill to corporate income for the present calendar year, 1936. It must be recognized that the choice of an income tax as the means for raising additional revenue necessarily involves a delay in realization of increased receipts. Receipts from taxes on corporate incomes for the calendar year 1936 will be collected in the main during the calendar year 1937 and will be divided between the two fiscal years, the fiscal year 1937, ending June 30, 1937, and the fiscal year 1938. The net additional revenue to be expected from the application of the corporate income tax is estimated to be \$310,000,000 in the fiscal year 1937. The full additional annual revenue would be collected in the fiscal year 1938.

The House bill follows the President's suggestions in providing for the repeal of the corporation income

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tax, the capital stock tax and the excess profits tax and by making dividends received by individuals subject to the normal tax of four per cent. In place of the repealed taxes it substitutes a new form of tax on corporate income with rates based on the percentage retained by the corporation. The estimated annual yield of \$623,000,000 is the amount by which it is expected taxes paid by corporations and individuals under the proposed plan will exceed the yield of corporate and individual taxes under the present law.

It is to be noted that the bill as passed by the House of Representatives, while failing, according to our estimates, to raise temporary revenues for a three-year period in the full amount sought by the President, utilizes but two of his three suggestions. The third was for the enactment of processing taxes on a broader

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base but with lower rates than were in effect under the Agricultural Adjustment Act. I call this potential source of additional revenue to your attention again. I feel sure that the Department of Agriculture stands ready to supply any information you may desire on this subject.

Turning from the revenue aspects of the House bill, in which the Treasury is primarily interested, let us consider also the two suggestions made by the President, to which the House bill gives effect from the standpoint of equity in our tax system.

As to the proposed unjust enrichment tax, I think there is little that need be said. I have not heard the justice of this tax very seriously questioned. There is no doubt whatever that the avoidance of payment

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of processing taxes accrued prior to January 6th has resulted in unjust gains to a limited number of persons and corporations. It would be grossly unfair to the persons and corporations who paid their processing taxes as due up to the time of the Supreme Court's decision and it would be unfair to the American consumer, who ultimately bore the major burden of the taxes, not to reduce this unjust enrichment as much as we can by taxation.

I take it for granted that an unjust enrichment or "windfall" tax will be enacted by the Congress. I assume, too, that you will give most serious consideration to the matter of the deficiency in the temporary revenue for a three-year period expected from the House bill as compared with the President's estimates of the need.

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I turn, therefore, to the proposed tax on corporate income.

The principle of taxation according to ability to pay is now well established, not merely by having been written by amendment into the Constitution of the United States and supported by twenty years of application in our tax structure, but by the undoubted and unquestioned endorsement and support of the citizens of this Nation. Through successive changes in our tax laws, however, we have departed most seriously from a consistent and just application of the principle. Under the existing law we apply the principle to individual incomes, whether they are obtained from interest, rents, or salaries, from the profits of individual business enterprise or from partnership undertakings. We do not apply it to profits gained

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from corporate enterprise, except in a manner which taxes some citizens at unfairly high rates and gives to others the opportunity to avoid taxation on a wholesale scale.

Where a corporation makes approximately full distribution of its current earnings, the stockholder under present law first bears the burden of three different corporation taxes -- the capital stock tax, the excess profits tax and the corporate income tax; second, he is required to pay surtaxes on the dividends paid to him. This stockholder thus pays what is in effect a normal tax of about 15 to 16 per cent as compared to a normal tax of four per cent paid by the individual who derives his income from other sources. On the other hand, the present law permits stockholders of large incomes to avoid the payment of surtaxes which

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may run to rates as high as 75 per cent on their share of corporate earnings which are not distributed as dividends.

What are the dimensions of tax avoidance with which we are dealing? A few simple figures tell the story. It has been estimated by the Treasury Department that under the present tax law the income tax liability of corporations on the basis of 1936 earnings would approximate 964 millions. The Department has also estimated that under the present law more than four and one-half billion dollars of corporation income in the calendar year 1936 will be withheld from stockholders and that if this income were fully distributed to the individual owners of the stock represented in these corporations, the resultant yield in additional individual income taxes would be about one billion three hundred

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millions.

With tax avoidance occurring on the scale indicated by the figures I have cited, I do not see how any increase in individual income tax rates or other general and continuing taxation could be justified until this leak in our tax system is stopped.

Whatever may be the debatable considerations that may enter into the preparation of particular schedules, it will be well to bear in mind at all times that this is purely and simply a proposal to put all taxes on business profits essentially on the same equitable basis; to give no advantages and to impose no penalties upon corporation stockholders that are not given to and imposed upon the individual taxpayer who alone or as a partner derives his income from business profits.

April 1941

H. M. Jr. told me to regard this for the Navy and  
Vicar what's as to increase money resources for war effort  
and not for economic reasons - 16 -  
to all investing money in the business because of the  
on account of inflation and it is not the same as  
referring to In closing let me say this. I sincerely  
connection with the same.

hope that this Committee will report to the Senate  
a bill giving effect, as fully as possible, to the  
President's recommendations of the amount of addi-  
tional revenue needed to supply the deficiencies  
created since the Budget Message of January 3.

April 27th

H. M. Jr. told me to record this for the diary that Viner wants us to increase excess reserves for psychological and not for economic reasons; that the American business man is not investing money in his business because he is frightened on account of inflation and if we made this move it would be reassuring to them - that we ought to do it on July 1st in connection with the bonus. This is Viner's latest viewpoint.

H.M.Jr. said that Wall Street is still in the doldrums, and that the head of the Federal Reserve is going on the Senate Tax Committee.



Monday  
April 27, 1936

HMjr: Hello -

Operator: Dr. Burgess -  
W.R.

Burgess: Sir?

HMjr: Hello, Burgess?

B: Yes, sir -

HMjr: Good morning

B: How are you?

HMjr: Fine - I don't suppose George Harrison is down so early - ?

B: Well, I haven't been in to see yet.

HMjr: Well - what I tell - you can pass it along to him and then if either of you is very much excited you can call me back.

B: Yes

HMjr: I've reversed myself or changed my mind or whatever you want to call it - I've decided it's a mistake not to sell some bills now.

B: Yes

HMjr: I'd like to begin on the fourth of May to sell fifty million dollars worth of bills a week due on the fifteenth of December and -

B:

HMjr: Pardon me?

B: Yes

HMjr: And that would be announced on Wednesday -

B: Yes

HMjr: - for next Monday.

B: Yes

HMjr: My reason for doing it is this - if everything goes along

lovely we can raise a billion dollars in June -

B: Yes

HMjr: If everything doesn't you'll come and say, 'Now, Mr. Secretary, can't you ask for around eight hundred - '

B: Yes

HMjr: ' - instead of a billion'. -

B: Yes

HMjr: And if we've raised these bills we can make it eight hundred.

B: Yes

HMjr: And - and if in the Fall things aren't so lovely instead of six hundred I - in bonds I would only have to raise four hundred.

B: Yes

HMjr: Now, if everything is fine in June we'll go out for a billion and we can cut our bills down or cut them out.

B: Yes, yes -

HMjr: But I just don't want to be in a position that on the first of June I've got to raise a billion.

B: Yes

HMjr: See? - Now nothing has happened except that after walking by myself - no one has talked to me - I just have gotten a little bit more cautious.

B: Yes, I see.

HMjr: I just want that anchor to the wind-ward.

B: Yes, yes

HMjr: Now - Bell and Taylor are here. As I told them if they thought I was making a great mistake I'd like them to tell me so.

B: Yes

HMjr: But unless they think it's a great mistake I'd like to follow my own judgment.

B: Yes, yes

HMjr: Now that's the way I feel.

B: Well, I don't think it's a great mistake.

HMjr: You don't?

B: No

HMjr: Well, I -

B: I'll talk with George.

HMjr: I wish you would and if you could call me back - either of you call me back between now and twelve o'clock -

B: All right.

HMjr: But I just want that little extra margin so that I don't have to raise a billion.

B: Yes, yes -

HMjr: I mean, if things aren't quite so - going so well - I mean I hear they've postponed the French election and if something happened abroad and our bond market wasn't just right eight hundred million is much easier than a billion.

B: That's true.

HMjr: And I just want to be in a position that I can turn around.

B: Yes, yes -

HMjr: And if I don't sell some bills I've got to raise the billion.

B: Yes, yes -

HMjr: Now there's nothing - you know me after a couple of years if I had anything - I'd either say I've got something I can't tell you -

B: Yes

HMjr: Or I'm telling you now there's nothing except -

B: Yes

HMjr: After sleeping on it, I myself - no one has influenced me - I - this is what I'd like to do.

B: Well, I can understand that.

HMjr: What?

B: I can understand that.

HMjr: Yes

B: Let me talk to George and call you back.

HMjr: You see, after all I'm a burnt child as I told you before -

B: (Laughter) yes

HMjr: And I've been <sup>in</sup> a period when things have steadily gotten better with occasional bad drops.

B: Yes

HMjr: And it's a much - I'm in a much healthier mind than a man who went through the - you know, twenty-nine and thirty and still thinks things are - everything is lovely.

B: Yes, yes - yes

HMjr: So, with that in mind, will you talk it over?

B: All right

HMjr: And if - my thought was, I have a regular weekly press conference at four and I thought I'd announce it in order to get the market ready.

B: Yes, yes

HMjr: See?

B: Let's see, that's - yes, that's just a week off.

HMjr: That would be out in tomorrow morning's paper, I mean announce it informally - the regular notices would go out Wednesday.

B: Yes, yes - yes

HMjr: But that's the whole story, Burgess, there's nothing behind it -

B: All right, well I can see it, I can understand it and I have a great deal of sympathy with it.



## TREASURY DEPARTMENT

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INTER OFFICE COMMUNICATION

DATE April 28, 1936

TO Secretary Morgenthau  
FROM Mr. Haas *HA*  
Subject: The Stock Market

I. SUMMARY

The recent decline in the stock market, following the 12-months' upturn, is to be associated with three developments:

(1) While first quarter earnings make a very favorable comparison with the first quarter of 1935, averaging about 25 percent higher, they fall sharply below the level represented by a projection of the exceptional fourth quarter 1935 earnings figures. This drop was to be expected, since the very high level of profits during the final quarter of last year was the result largely of the advanced automobile season with its stimulating effect on allied industries such as steel, automobile parts, glass, textiles, tires, and rubber. It took actual first quarter figures, however, to drive home to the market the exceptional nature of fourth quarter earnings. Once the facts were appreciated, readjustment of values was inevitable.

(2) During the fourth quarter of 1935, an inflationary psychology was engendered by good profits showings and rapidly expanding business activity, and was carried to a higher pitch by (a) knowledge that the bonus would be paid, without any corresponding certainty as to how it would be financed or when it would be spent; (b) the talk of currency inflation which was much in evidence during the final months of last year; and (c) the belief that heavy new taxes in an election year were unthinkable.

Since the beginning of this year, the pause in the recovery movement has somewhat dampened the inflationary feeling; bonus uncertainties have been largely dissipated; most important of all, the Administration has submitted a tax message, evidencing its determination to adhere to the budget. Consequently, the inflationary psychology has died down. It is not surprising that the coincidence of these developments with the necessary readjustment of earnings expectations would tend to place the market in a weak position.

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(3) Finally, certain technical features of the market under the new regulatory legislation make for sharp swings both upward and downward, as compared with pre-SEC conditions. These aspects of the current decline are discussed in more detail below.

#### Conclusion:

The conditions which we have outlined indicate that the market was in a vulnerable position preceding the recent decline. Under these circumstances, any bearish news would be likely to touch off or to accentuate a decline. It is possible, as financial journalists suggest, that such factors as "the embargo placed on gold by Poland . . . the French election . . . (and) the attempt of the Securities and Exchange Commission to suspend White, Weld & Co. . . ." (New York Times, April 28) played a part in the recent decline. The market has resisted shocks of this sort in the past, however; it probably would have done so again if underlying factors had not laid the ground for a downward readjustment of values.

There is no reason to anticipate more than a corrective movement. We are still in the upward phase of the business cycle; a fall revival in business seems beyond doubt, money is easy, capital is abundant. After a re-appraisal of the outlook, it is to be expected that the market will again give the most weight to longer-term prospects for further recovery.

1. Price Re-adjustment in Line with Failure of First Quarter Earnings to Represent Projection of Fourth Quarter Figures

In the final six months of 1935, the heavy industries, and particularly construction, were showing the first upturn of the recovery period. Prices evidenced an anticipation that the upturn would continue at the same rate through the early part of 1936.

Building and railroad equipment stocks, particularly the former, were eagerly bought. There are not many building stocks. Their prices were consequently bid up to levels justified not by 1935 earnings, but by the prospect of a building "boom" in 1936. Rail equipment stocks, too, were in the limelight as affording opportunities for wide "leverage" gains. First quarter 1936 profits were expected to provide the first justification of high prices for stocks of this type bought on "prospects."

Meanwhile, the final quarter of 1935 turned in a brilliant profit showing, considerably above the most optimistic expectations. While full year 1935 earnings for industrial corporations averaged about half again as high as in 1934, compilations of fourth quarter profits showed gains of as much as 220 percent (Standard Statistics quarterly index of 120 industrials) over the like period of 1934. This showing added to the soaring optimism in the market, an optimism which was undismayed by the knowledge that a large part of fourth quarter earnings was dependent on the double automobile season in 1935. Prices for stocks such as building equipment, where earnings were still low, went to levels justified only by the prevailing notion that the upward sweep in earnings would continue unabated in 1936.

Following the exciting events of 1935's final quarter, a series of sobering developments have occurred since the first of this year:

- (1) First quarter earnings have not represented a projection of fourth quarter expectations. Aggregate first quarter profits showings, while they compare very favorably with first-quarter-1935 figures, are sharply down from the high peak of the final quarter of last year. Hasty profit taking and a rapid scaling down of earlier ideas has followed.

In retrospect, it is evident that a consolidation of gains has been in progress throughout the first quarter. An unofficial compilation indicates that 292 stocks reached their highs in January, 410 in February, 303 in March and 168 in April.

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- (2) It has become evident that there will be no building "boom" in 1936, although operations will undoubtedly be considerably better than last year. First quarter profits showings of the leading building equipment companies are not only unfavorable; they appear to have taken the market by surprise. Building stocks were leaders in the decline.
- (3) The market has again become aware of the fact that railroad equipment orders are always spasmodic; it is recognized, now, that the large January-February orders placed by the railroads do not necessarily mean that the same rate of buying will continue through 1936.
- (4) Most important of all, the business scene today contrasts sharply with the fourth quarter of 1935 in one important respect, of crucial significance to those looking for "leverage" stocks: the market foresees no big stimulus to business activity in the weeks just ahead. The outlook for building is favorable, but the realization that no "boom" is imminent has been one of the chief items in the markdown of earlier prospects for sharply accelerated revival in the near future.

## 2. Dissipation of Inflationary Psychology

As we have noted in the summary, an inflationary psychology was strikingly evident in the fourth quarter 1935 stock market. It found one expression in heavy buying during this period of low-priced, speculative issues, so-called "cats and dogs." Margin regulations made it relatively expensive, it is true, for the general public to speculate in higher priced investment stocks. But the heavy and persistent purchases of low-priced issues gave witness to the general belief that the market would continue to inflate, balloon-like, carrying both good and bad stocks with it.

This inflationary psychology is gone; the solid strength in Governments which has accompanied the decline in stocks gives added evidence of the change in feeling. On April 27 the Dow-Jones industrial stock average fell almost 5 points to 147, dropping below the low point which Dow theorists stated (Barron's, April 27) marked definite reversal of the long March-to-March uptrend. Governments, however, held firm. The yield on 10 long-term Treasury issues averaged 2.511 at April 27 prices, as against 2.510 a week ago, 2.507 a month ago, and 2.564 six weeks ago, before stock prices had shown a tendency to recede.

## 3. Technical Features of Trading under New Regulatory Legislation

Certain features of the new regulatory legislation make possible exceptionally sharp price swings, both upward and downward. In particular, the new regulations make for a much thinner market than formerly prevailed; while a downturn is in progress, this means that there are fewer cushions to retard the decline.

Since the passage of legislation affecting the security markets, it is reported that short selling, requiring subsequent covering, has been greatly reduced and in some cases eliminated. Insiders are prevented from speculating as much as formerly and so are less apt to give their stocks support in a falling market. Pools, too, which in times past often established a low on the decline, are virtually out of existence. These absent elements are not to be mourned; but their disappearance has greatly thinned the ranks of available offerings and bids during periods of sharp price change.

April 27, 1938

HM, Jr. had a very satisfactory talk with Mr. Eccles this morning. He said he never found Eccles easier to talk to.

Eccles said that he feels that Oliphant and Haas, not having had business experience, are making many mistakes on corporate taxes and that when HM, Jr. goes up on the Hill to testify on the tax bill he should confine himself only to the fiscal end in order to be on safe ground.

Eccles also said to HM, Jr. that he does not want to do anything on excess reserves until July 1 and the only people whom he thinks will urge him to do it immediately are Broderick and Szymczak, but that he can see no need for doing it now.

He also told HM, Jr. that the Federal Reserve do not have enough power to stop inflation if we continue to have these big budgetary deficits and that we ought to balance the budget by 1938; that the only way to stop real inflation is to stop budgetary deficits and HM, Jr. agreed with him entirely.

This conversation gave Mr. Morgenthau the thought that it would give him a grand opportunity to say, immediately after the second paragraph of the statement which he is going to read on the Hill, Thursday morning, "that the reason that I am so anxious to see this money raised is to put the President's budget back to where it was and the only way to do this is to stop this gradual tendency towards deficit inflation and that the only way to stop it is to balance the budget through additional taxes and I sincerely urge <sup>on</sup> Congress that they raise these additional taxes as this is the one and only means to stop inflation."

HM, Jr. was not sure that he would use this last paragraph, but in any event he wanted to put it down on paper.

April 28, 1936

Mr. Morgenthau today asked Mr. Chen to come in to see him. Chen was in conference with Lochhead and Taylor this afternoon.

HM, Jr. told Chen that he had received a message from Professor Buck to the effect that Dr. Kung was disturbed because of the prospect of the National City Bank making a loan to the Canton Government of \$750,000 on silver. The Secretary told Chen that he could cable Dr. Kung that the National City Bank will not make the loan.

He said that this is another gesture on our part to show that anything that we can do to help China, we will do.

HM, Jr. called the President at 5:30 and told him that something quite exciting has just happened; that we have had an order in London for quite a while to buy gold at \$34.77, which is below the gold export point in England. In other words, when it goes down to \$34.77 it is profitable for an American bank to buy gold and deliver it to us at \$35.00. Something has happened and we suddenly find that we bought \$750,000 worth of gold. We had our price in for safety to keep the market from cracking and suddenly we discovered that we bought \$750,000 in gold. He also told the President that he did not understand the significance, but he thought it was important enough to tell him about it.

April 28, 1936

At 7:30 p.m., HM, Jr. called Secretary Hull to tell him about the \$750,000 worth of gold that was bought in London.

During the conversation, Hull asked Mr. Morgenthau whether Taylor had talked to him about the French trade agreement which needed the Treasury's approval. HM, Jr. told Hull that Taylor had not, but that he would see him later in the evening and would talk to him about it then.

Taylor did talk to Mr. Morgenthau during the dinner at the Chinese Embassy and told Mr. Morgenthau that the State Department were again "putting the screws" on us and wanted our O. K. that night because if they did not get it, Minister Bonnet would miss his boat the next morning. HM, Jr. told Taylor that he would leave the responsibility with him as to whether Bonnet would sail or not. Whatever he did, he said, he would back him up.

The next day Taylor reported that Williamson, of the State Department, had told him that Bonnet did miss his boat, but certainly not on our account.

Taylor reported that the way the thing is set up in the agreement, at present, he does not feel that in case of devaluation the United States Government would be properly safeguarded and HM, Jr. told him that he left it entirely up to him and that if he feels that the United States is not protected, he should see that we are.

April 28, 1936

HM, Jr. today asked Dr. Burgess what in his opinion was the significance of General Goering taking Dr. Schacht's position as fiscal dictator for Germany.

Dr. Burgess' views on this subject are as follows:

"There are two views about this whole matter:

1. That this is an arrangement taking power away from Schacht and cuts him off from Hitler.
2. This arrangement as worked out is a method of continuing Schacht in power and giving him more authority with the Nazi party.

Nobody knows which one is correct. The tendency is to have confidence in the second view."

Tuesday  
April 28, 1936

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HMjr: Hello?

Treasury

Operator: Mr. Cochran -

HMjr: Hello - hello -

New York

Overseas

Operator: Just a moment, please.

HMjr: Hello -

O. O.: I'm sorry to keep you waiting, Secretary Morgenthau, we're having a little difficulty with our circuit. May I call you back?

T. O.: Operator, I'll hold the line.

O. O.: All right, thank you.

T. O.: I'm sorry, Mr. Morgenthau, he was on there once.

HMjr: Who was the girl, was that the French operator?

T. O.: Yes

O. O.: This is New York Overseas.

T. O.: New York Overseas -

HMjr: All right - (Pause) (Spoken aside: Oh, I'm - tell him I've got this overseas phone call)  
Hello -

H. M.

Cochran: Hello, Mr. Morgenthau -

HMjr: Cochran, I'll talk until - I'm having - maybe have to hang up any minute because I may have a call from another man, see? - Hello?

C: Yes

HMjr: I wondered if you could get me a cable today on the Polish situation - hello?

C: Yes

HMjr: And also on the - this latest move on Schacht.

C: I see.

HMjr: Hello?

C: Yes

HMjr: I mean, I'd like to get as much information as I could on those two things.

C: I see - all right.

HMjr: Do you think you can pick up much in Paris?

C: I was at the Bank of France this morning and talked to them on Poland.

HMjr: What's that?

C: I say, at the Bank of France this morning I talked to them on the Polish question.

HMjr: On the Polish question?

C: Yes

HMjr: Yes

C: And they said please don't consider that there has been a gold bloc.

HMjr: I didn't understand that.

C: They said please do not get the idea that there has been any deflation in the gold bloc.

HMjr: Any what?

C: Any - any gold bloc - any gold bloc from the gold system that in the action of one could influence or bind another.

HMjr: You mean that the Polish - the Polish thing would not influence France?

C: Not in the least.

HMjr: What?

C: That's what I mean - it will have no influence whatever on French monetary policy.

HMjr: Well, do you believe that?

C: Yes

HMjr: Do you really?

C: Yes - I think it may have contributed yesterday to the decline on the stock market.

HMjr: What's that?

C: They had a bad stock market here yesterday.

HMjr: Yes

C: This Polish affair may have contributed some to that.

HMjr: Yes

C: But the franc today is not at the gold export point very steady.

HMjr: Now I wish you'd find out for me today from the American banks and the American stock exchange houses in Paris -

C: Yes

HMjr: - whether there is much buying or selling one way or the other of American securities.

C: I see.

HMjr: And whether the selling - it's selling or buying which is going on the last couple of days.

C: I see, all right.

HMjr: Do you think you can find out?

C: Yes, I think I can.

HMjr: Yes - I mean whether there is more buying or more selling through American banks and stock exchange houses of our securities.

C: During the last few days?

HMjr: Well, in the last -

C: Well, since the market's fallen.

HMjr: Yes

C: Yes

HMjr: I mean, whether their selling is coming from Paris or not, see?

C: Yes, all right.

HMjr: And get me a cable on that. Now on the Schacht thing - pick up what you can, will you?

C: All right - I can't promise Poland or Germany this afternoon, I'll get it if I can, but it's long distance.

HMjr: Well, I am -

C: I have written my telegram on the French situation and it is being coded now -

HMjr: Yes

C: And I'll get - I can get something on both of them, I think, sir.

HMjr: You can?

C: Yes

HMjr: All right - Now, I gather from our word here that today things are a little quieter - ?

C: Yes, today it's quieter here.

HMjr: Yes

C: The French francs have recovered a little bit.

HMjr: Yes

C: And there is practically no intervention by the British Control.

HMjr: I see.

C: The franc is steady against both the dollar and the sterling.

HMjr: There has been no intervention?

C: No, practically none. And no - no sales of dollars for gold shipments.

HMjr: No what?

C: There are no dollars being sold to finance shipments of gold to New York.

HMjr: I see.

Monday  
April 24, 1934

C: There's nothing doing there.

HMjr: Well, that's - all right. Everything else all right?

C: Everything is going very well.

HMjr: All right.

C: Of course Sunday was the big day and it's too early yet to say what is going to happen.

HMjr: All right.

C: But I'll wire you every day and I'll get these messages over just as soon as I can.

HMjr: All right.

C: Fine

HMjr: Thank you.

C: All right, Henry.

HMjr: Goodbye.

C: Goodbye.

C: It was believed that the market was going to be lower.

HMjr: It would go another?

C: I should think so.

HMjr: But you don't think there's any - any particular -

C: I don't think there's any such thing as an organized sale or anything to make things disappear.

HMjr: Yes.

C: There - as a matter of fact, Henry, there are 1000 and pockets on both sides of the market.

HMjr: I see.

C: They - the market can go down very easily because there aren't any buyers.

HMjr: My own belief is that the only - that the danger is part of this market would be that if the market started to get a break as we were used to old times that it could go

Tuesday  
April 28, 1936

HMjr: Hello -  
J. P.  
Kennedy: Hello, Henry  
HMjr: Hello, Joe  
K: How are you, my boy?  
HMjr: I'm fine, how are you?  
K: I'm fine.  
HMjr: Joe -  
K: Yes, sir  
HMjr: Can you give me your interpretation of what's been happening the last few days in the market?  
K: Yes, but I mean I don't think that there's any particular significance to it, Henry. I think that it - a market that has gone up for thirteen months and people would have sold at a good deal less price except the fact that they were afraid to pay taxes.  
HMjr: I see.  
K: My own belief is that the market can go another five points lower.  
HMjr: It could go another?  
K: I should think so.  
HMjr: But you don't think there's any - any particular -  
K: I don't think there's any such thing as an organized sale or anything to make things disagreeable.  
HMjr: Yes  
K: There - as a matter of fact, Henry, there are very bad pockets on both sides of the market.  
HMjr: I see.  
K: They - the market can do down very easily because there aren't any buyers My own belief is that the only - that the dangerous part of this market would be that if the market started to get a break as we were used to old breaks that it could go

very very badly against you because there are no buying powers. The only reason that you haven't got a really good panic on at the minute is because the fifty-five percent margin still keeps people in pretty fair shape.

HMjr:

I see.

K:

Now, if you got a break that went beyond another five at this point you would - I think you might uncover some things and then people might get a little bit scared.

HMjr:

Yes - well, of course it hasn't touched my bond market at all.

K:

No, and it won't touch the bond market.

HMjr:

Well, then what have I got to worry about?

K:

Well, as far as the bond market is concerned, Henry, it won't do it a damn bit of harm.

HMjr:

Yes, well -

K:

Because, after all that is going to be based on your credit and - and on the fact that money is still cheap and according to this it's going to make another problem.

HMjr:

Yes

K:

It won't affect you - as a matter of fact in spite of the fact that this is rather a bad sounding issue today - this hundred and ten million - they may have some difficulty with it but they'll all go over a little later.

HMjr:

Yes

K:

There's no trouble, Henry, as far as the bond situation goes - it's just - the New York crowd always starts to 'belly ache' but hell, if you go outside of a place where they don't know that - that there is a stock market, such as New York or Chicago -

HMjr:

Yes

K:

- or Boston, Christ, they won't even know what's going on.

HMjr:

Yes, well I - I wanted to talk to somebody who knew the technique of the market and I didn't know anybody

better than you.

K: Well, thank you, Henry. My own belief is that the market can go down - I don't think that it is a designed market - I think that these fellows have held on - I think it's directly attributable to a too high a price based on the fact that people don't want to sell them.

HMjr: Well, that's - that's a perfectly good reason.

K: And pay for a capital gain tax - and that leaves a hell of a wide pocket in the market that can fall on its face any time they all start to sell.

HMjr: Well -

K: I tell<sup>you</sup>, Henry, I think that they're contemplating - things are - I don't know how far along they are but over in the Commission -

HMjr: Yes

K: - it might have some bearing on narrowing the stock market.

HMjr: Narrowing it?

K: Yes, in other words if they decide to do away with professional operations -

HMjr: Yes

K: - which is a thing discussed. As a matter of fact the day of that work-down there Burns and Haley talked to me about it.

HMjr: Yes

K: I don't think they'd ever do anything until at least they get a practical man who can discuss it with them. But if that were to happen - to me that would limit restricted margin and might cause serious breaks.

HMjr: Well, of course, you know I'm not in close touch over there.

K: Well, I - I can follow that and I don't think that - I'm quite sure that they would at least take my judgment on - as far as that and I don't think anything ought to be done before election.

HMjr: Well, if you hear of anything which would affect the bond market which is my responsibility -

K: Yes

HMjr: I'd appreciate your giving me a ring.

K: Henry, it would be a great pleasure. But I wouldn't worry - it's a cinch. I'm writing up some answers to some of these fellows and one of the things that we're stressing pretty definitely is the fact that - of the financing and the way it's been done and as cheaply as it's been done and I'm going to - it will take me another two or three weeks to finish it and then I'm going to show it to the 'Boss' and I'll let you read it to see how you feel about the Treasury situation.

HMjr: What are you doing, writing an article or a book?

K: No, it's an answer to Warburg and Hoover and Smith.

HMjr: Oh - I'd love to see it.

K: And - I mean, they're talking about all this Government credit getting a kick and I'm demonstrating that it never was so good.

HMjr: (Laughter) I'd love to see it.

K: I'll send it to you.

HMjr: O. K.

K: All right, Henry

HMjr: Thank you

K: Thank you for calling.

HMjr: Goodbye.

April 29, 1936.

Bewley asked to come in to see HM, Jr. to discuss sale of \$750,000 gold by Bank of England to the US Treasury and Bewley asked by HM, Jr. to inquire of the British Treasury the significance of the transaction.

HM, Jr. I do not know whether you have seen the London Times last night. Our cable news at that time stated that the Bank of England had sold \$750,000 gold to the US Treasury and stood ready to buy. This news was given in the Times and in case there should be a story in any other paper ready to buy. We did that news before. Last night's news was a surprise.

Filed in Stabilization Folder under date of April 29, 1936.

States Treasury \$750,000 worth of gold. (The news appeared in the New York Times with a story attached.)

Mr. Bewley: How does the \$24.77 price work?

Mr. Lockhead: \$24.77 is the market price when the gold was sold in London and when for the purpose of shipping to New York for sale in New York at \$24.80 an ounce. The 3 cent decrease of the market represents shipping charges, insurance, etc.

HM, Jr. The purpose of our having this order to buy is it would be there in case of an emergency, as a matter of fact, we are a little curious to know where gold is, what was the nature of the transaction. Unfortunately, there is a wall between us and it seems to be dark on both sides and we cannot see. If the British Treasury felt so inclined to sell us the significance of the transaction, I would be glad to receive it.

Mr. Bewley: I will let them know, will please.

HM, Jr. The fact that they sold it to us makes their willingness to sell and our willingness to buy, but we are still sitting in the dark.

Mr. Bewley: They are not sitting in the dark.

HM, Jr. No. They say they don't know the location, but we are in the dark.

Mr. Lockhead, we have again received the gold.

April 29, 1936

Mr. Bewley called on Mr. Morgenthau at 11:30. The following is a transcript of their conversation:

HM, Jr: I do not know whether you know what happened in London last night. For some time we have had an order in with the Bank of England that if and when gold should reach \$34.77 we stood ready to buy. This order has been in for quite a while and in case there should be a break, we were there, ready to buy. We did that once before. Last night (3:30 our time) we got word through the Federal Reserve Bank of New York that the Bank of England had sold to the United States Treasury \$750,000 worth of gold. Reference to this sale appeared in the New York Times this morning. (Clipping attached.)

Mr. Bewley: How does the \$34.77 work out?

Mr. Lochhead: \$34.77 is the maximum price which can be paid for gold in London and allow for the expenses of shipment to New York for sale in New York at \$35.00 an ounce. The difference of 23¢ an ounce represents shipping charges, insurance, etc.

HM, Jr: The purpose of our having this order in was so it would be there in case of an emergency, as a cushion. Naturally, we are a little curious to know whose gold it was; what was the nature of the transaction. Unfortunately, there is a wall between us and it seems to be dark on both sides and we cannot see. If the British Treasury felt so inclined to tell us the significance of the transaction, I would be glad to receive it.

Mr. Bewley: I will let them know, with pleasure.

HM, Jr: The fact that they sold it to us showed their willingness to sell and our willingness to buy, but we are both moving in the dark.

Mr. Bewley: They are not moving in the dark.

HM, Jr: No. They may know what they are knowing, but we are in the dark.

Mr. Lochhead, we have again renewed our order?

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Mr. Lochhead: Yes. We keep a standing order good until the end of the week. It is renewed automatically each week.

Mr. Bewley: I will be very glad to inquire. I can only express my complete ignorance. They do not keep me informed of day-to-day transactions.

HM, Jr: This may have no particular significance at all. My guess is that we are moving in the same direction, but I do not know.

Mr. Bewley: I will try and find out for you.

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NEW YORK TIMES

April 29, 1936

**Bank of England Buys Gold**

The Bank of England was reported yesterday to have bought £137,310 of gold. This was another of the numerous small purchases that the Bank has made at fairly frequent intervals in recent years and which have been gradually lifting its gold reserves to higher levels. It is generally assumed that such purchases are made from the British Equalization Account and involve some bookkeeping, which will have to be unraveled when Britain finally revalues the pound. The Bank still carries its gold at the old statutory price, which is equal to somewhat less than 85 shillings an ounce, against the present market price of 140s 10½d. For it to purchase at the market price would involve an immediate bookkeeping loss. Instead, it is be-

lieved, the Bank buys from the exchange fund at the old rate, the latter absorbing the loss for the time being. When the time comes to revalue the Bank's gold the "profit" will, if precedent established in other countries holds good, go to the British Treasury, of which the exchange fund is a branch.

Dr. Tule  
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NEW YORK TIMES

April 30, 1936

## TOPICS IN WALL STREET

### Gold From London

Yesterday's decline in the price of bar gold in London's open market

to 140s 9½d an ounce made it possible for the first time in many months to ship gold from London to New York at a profit. Recent gold shipments billed as from England have, in fact, originated in India; but yesterday \$366,000 was bought in the London market for American account. The London gold price was equal to \$34.7623 an ounce and, after adding the costs of shipping, insurance and handling charges, as well as interest on the funds employed, the gold could be landed here at a cost of \$34.9998 an ounce, against the present United States price of \$35. The flow of gold from other countries is beginning to assume the proportions of an important movement. At the present time there is \$23,200,000 gold on the way here, of which \$18,200,000 is coming from France, \$1,200,000 from England and the remainder chiefly from India. The first shipments of the gold engaged in France last week are due to reach here today.

*✓ German Counteracting Duties*  
TREASURY DEPARTMENT

151

INTER OFFICE COMMUNICATION

DATE April 29, 1936

TO The Secretary  
FROM General Counsel's Office

Justice officials have just completed their conference with the officials of the State Department (Hackworth, the Legal Adviser and a German gentleman), on the German matter. They presented no legal objections to the views of the Treasury Department which appeal to the Justice officials. They presented mostly objections on economic and policy grounds. They were advised that Justice is not concerned with such questions. They requested an opportunity, however, to furnish a memorandum on the economic and policy aspects of the matter to be transmitted to the President with the Attorney General's opinion. They have promised to furnish the memorandum by tomorrow, and Justice has agreed to wait until that time before transmitting the Attorney General's opinion to the President.

*Flora McGuire*

TREASURY DEPARTMENT

152

INTER OFFICE COMMUNICATION

DATE April 29, 1936.

To Secretary Morgenthau  
FROM General Counsel's Office

Re: German Countervailing Duties

Justice has the opinion prepared. It will be sent to the President this afternoon unless the State Department representatives, who have asked Justice to permit them to present their views, change Justice's view on the matter.

We are to be advised of the outcome of the conference, and the time of the transmitting of the opinion to the President.

*Flora McGuire*

April 29, 1936

United States Attorney Hardy called on the Secretary today accompanied by Assistant United States Attorney Martin. They were presented to the Secretary by Mr. Gibbons, who remained for the meeting. Also present were Mr. McReynolds and Mr. Irey.

Mr. Hardy said that while he did not want to reflect upon the Narcotic Squad at all, it was significant to him that they don't produce the man who is financing the operations and who is the wholesaler and not the retailer; that they have been bringing in only the peddlers. He considers it essential that there be an intensive drive to get at the source of distribution, conducted by a group of investigators unknown to the Narcotic Squad in New York supplemented by some of J. Edgar Hoover's Bureau of Investigation men. He suggested the latter because they have the records of the men engaged in the sale of narcotics as they usually are involved in other crimes. The drive, he said, would be preliminary to a Grand Jury investigation, and it would be a joint drive by both Treasury and Justice.

HM, Jr's comments were as follows: "It is usually the other way round. We usually have to push the District Attorney and if you, as District Attorney, want to push us that's swell! More power to you! That's my attitude. Ever since I have been here, I think you are the first one who has come in and wanted to bring pressure. Nothing pleases me more. So if you are getting ambitious, we will give everything we have to help you." He then explained the set-up of the different investigating agencies in the Treasury and told Mr. Hardy that only last week he had signed an order that Mr. Harold Graves is to head up any contact with another Department of an investigative nature and that Graves can call on anyone in the Treasury who has police work to do. Graves, he said, has full authority over all the police agencies of the Treasury and can draw on Coast Guard or Secret Service, Narcotics or Internal Revenue agents which Mr. Irey heads up.

The Secretary immediately called Graves on the 'phone and told him that Mr. Hardy was in his office and asked him to confer with Mr. Hardy and to give full cooperation, which Mr. Graves said he would do.

Before Mr. Hardy departed, HM, Jr. called to his attention to the fact that it was a Narcotics agent in Paris who had

-2-

found the large quantity of stolen bonds and it was the Treasury who had informed the New York police. Mr. Hardy inquired if that was the story reported by the press that an anonymous telephone call was the source of the information on which the New York police had made the arrest and HM, Jr. said it was. HM, Jr. told Mr. Hardy that just to be certain, Graves had called Mr. Valentine who had said that it was the Mayor's publicity manager who had ordered that the story be handled the way it was.

April 29th

Saw the President this morning. My purpose in going to see him was to try to get his permission for me to open conversation with the British on stabilization. The President must have talked to me for half an hour along the lines that the first move must come from the British; that when it comes to international finance they have had years of experience and they have been used to dictating to the World. I reminded him that we had not done so badly ourselves and have been able to hold up our end. He said, "you and I, of course, started with no knowledge of this subject but the two of us have done well and have been able to more than hold up our own end". He said, "the trouble is that when you sit around the table with a Britisher he usually gets 80% out of the deal and you get what is left". He said, "tell them that. Tell them that if we get 45% we think that would be doing well". He said that, "as long as Neville Chamberlain is there we must recognize that fundamentally he thoroughly dislikes Americans." The President, of course, himself thoroughly distrusts the British and I think in his heart is a little bit afraid to talk to them for fear that they will get the best of the bargain.

I kept putting steady pressure on him to let me talk to Bewley. I told him, "after all, Mr. President, you can trust me and I trust myself to hold up my end of the argument". I said, "it is perfectly silly for two countries to be doing business together in the dark with a big wall between us, each country slipping the other country a note under the wall but not being willing to talk to the other person". I said, "I want to open a channel of communication. I think it is very important". I kept up this steady pressure on him and he finally gave in and said that I could see Bewley but I simply should say to Bewley, "now last night we bought through the Bank of England \$750,000 worth of gold and were only curious to know, as the buyer, whose gold we bought and what significance there is in this transaction" and that I should give him this little talk about the wall between the two countries.

After thinking it over I believe I will confine my conversation simply to telling Bewley of the transaction and asking him if he can get the information as to the significance and this will give him a chance to open up if he wishes to at another visit.

I said to the President, "I do not know what went on in the London Economic Conference and I have not got that background" and he said, "have you got copies of the cables in my private files" and I said, "no" and he told Miss LeHand to give them to me.

What I did not tell the President, because I did not want to irritate him at this time, was that the English definitely feel that he double-crossed them in the summer of 1933 and that is why they have acted so peculiarly about stabilization ever since.

Department of Justice  
Washington  
April 30, 1936

*Handwritten notes:*  
H.M. G.  
at  
...



MEMORANDUM FOR THE ATTORNEY GENERAL

Re: Proposed Treasury Decision Giving Notice of the Imposition of Countervailing Duties on Certain Imports from Germany under Section 303 of the Tariff Act of 1930.

I.

REFERENCE TO AND STEPS TAKEN BY THE ATTORNEY GENERAL

On April 17, the President handed to the Attorney General "For Report and Recommendation" a letter respecting the above subject from the Secretary of the Treasury to the President, dated April 16, 1936, together with a summary of the opinion of the General Counsel for the Treasury Department, dated April 15, 1936, and a copy of a letter to the Secretary from the Secretary of State, dated April 2, 1936, enclosing copy of a confidential report to The Executive Committee on Commercial Policy from the Subcommittee on Countervailing Duties in Relation to Currency Problems, dated March 28, 1936. On the same day the Attorney General assigned the matter to the Assistant Solicitor General.

Upon a study of the documents received from the President, it was found that neither a copy of the proposed Treasury Decision, nor of the opinion of the General Counsel for the Treasury Department accompanied the documents transmitted to the Attorney General, and that without them no sufficient factual basis existed upon which the requested report and recommendation could be made. It was also obvious that a divergence of view respecting the proposed imposition of countervailing duties obtained as between the Secretary of the Treasury and the Secretary of State. For these reasons, on April 18, 1936, the Attorney General advised the Secretary of the Treasury and the Secretary of State of the President's request for report and recommendation, asking the former for the missing documents and affording the latter an opportunity to present such additional views as he might care to submit.

Under date of April 22, 1936, the Secretary of the Treasury transmitted the desired documents, together with others, and on April 24,

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1936, the Secretary of State welcomed the opportunity of submitting his views through conference between his Legal Adviser and a foreign exchange expert with representatives of this Department. Since receipt of these communications from the respective Secretaries, conferences have been held with the representatives of each and the matter has been given our careful consideration. The endeavor will be made in this memorandum to present to the Attorney General as briefly as possible the existing situation, the divergent views of the Treasury Department and the State Department, and the conclusions at which I have arrived. It would serve no purpose to attempt here to restate the more detailed position of the Treasury Department set out in the opinion of its General Counsel to the Secretary, dated April 15, 1936, which is attached for reference; or that of the State Department in the annexed letter from Secretary Hull to Secretary Morgenthau, dated April 2, 1936,--which is expected to be supplemented by a further memorandum under preparation in the State Department, which will be attached.

I may state at the outset that because of the important questions of foreign policy involved and the conflict between the views of the Treasury Department and those of the State Department, I think that it will be advisable for the Attorney General to confer personally with the President on the problem, and I anticipate that the President may also wish to hear the two Secretaries before resolving the question.

## II.

### THE QUESTION AND THE CONSTRUCTION OF THE TARIFF ACT OF 1930 UPON WHICH DEPENDS THE ANSWER.

Briefly, the question is whether Germany, through certain devices, must be held under Section 305 of the Tariff Act of 1930 to "pay or bestow, directly or indirectly, any bounty or grant upon the manufacture or production or export" of certain dutiable articles or merchandise manufactured or produced in that country. If so, the Act provides that upon importation of such articles into the United States "there shall be levied and paid, in all such cases, in addition to the duties otherwise imposed by this Act, an additional duty equal to the net amount of such bounty or grant, however the same be paid or bestowed." The Act requires that "the Secretary of the Treasury shall from time to time ascertain and determine, or estimate, the net amount of each such bounty or grant, and shall declare the net amount so determined or estimated," empowering him to make all regulations which he may deem necessary for identifying such articles and assessing and collecting such additional duties. It will thus be observed that the duties of the Secretary of the Treasury under the Act are mandatory. Therefore, if in fact Germany does "pay or bestow, directly or indirectly, any

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bounty or grant" upon the manufacture or production or export of such articles, the Secretary must levy and collect "an additional duty equal to the net amount of such bounty or grant, however the same be paid or bestowed." The inquiry is whether the practices being pursued by Germany respecting exports to this country constitute bounties or grants within the comprehensive language of the statute which has been indicated above by underscoring. It is obvious from the language itself that the scope of the Act is very broad, and the Supreme Court has said of it that:

The statute was addressed to a condition and its words must be considered as intending to define it, and all of them—"grant" as well as "bounty"—must be given effect. If the word "bounty" has a limited sense the word "grant" has not. A word of broader significance than "grant" could not have been used. Like its synonyms "give" and "bestow," it expresses a concession, the conferring of something by one person upon another. And if the "something" be conferred by a country "upon the exportation of any article or merchandise" a countervailing duty is required by Paragraph E. Nicholas v. United States, 249 U.S. 34.

I think it plain from the statute itself that it was intended to anticipate as inclusively as possible all practices and devices which might be resorted to or invented to circumvent the statute by obscuring or concealing their purposes as bounties or grants. The history of the Act fully corroborates its purpose to make impossible its evasion by indirection or disguise. In the case of Nicholas v. United States, supra, Great Britain paid certain amounts as "compensation" in addition to the remission of inland revenue taxes upon exportation of liquor to the United States. Countervailing duties equal to the net amount of the "compensation" were imposed and the imposition was sustained by the Court, which after using the language quoted above said:

We have the fact of spirits able to be sold cheaper in the United States than in the place of their production, and this the result of an act of government because of the destination of the spirits being a foreign market. For that situation Paragraph E was intended to provide.

In an earlier decision in the same case (Nicholas v. United States, 7 Ct. Cust. Appls. 97), the Court of Customs Appeals after commenting upon the clarity of the language and purpose of the statute said:

Whenever a foreign power or dependency or any political subdivision of a government shall give any aid or advantage to exporters of goods imported into

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this country therefrom whereby they may be sold for less in competition with our domestic goods, to that extent by this paragraph (E) the duties fixed in the schedule of the act are increased. It was a result Congress was seeking to equalize regardless of whatever name or in whatever manner or form or for whatever purpose it was done.

In reply to the contention that the "compensation" was a reimbursement of extra costs imposed on the goods by British excise regulations, the Court of Customs Appeals said:

The fact that the payment made by the foreign government was estimated or calculated upon a basis or in consideration of extra burdens imposed by domestic excise laws, or for any other reason of domestic government or policy commending itself to the wisdom of Parliament is not controlling with our courts. The sole inquiry is, do the results of such acts stimulate exportation or give a special advantage by affording aid from the public treasury whereby such goods may when exported be sold in competition with ours for less.

With this construction of the Act in mind, it remains to determine whether the practices and operations of the German government with respect to exports to this country constitute bounties or grants requiring the imposition of countervailing duties. The Secretary of the Treasury in his letter to the President says, "I am satisfied that, under the circumstances, I have no choice but to sign and issue this Treasury Decision." The Secretary of State in his letter to Secretary Morgenthau expresses great concern at the latter's conclusion, particularly from the standpoint of economic policy in our trade relations with Germany; and while fully recognizing the mandatory nature of Section 303 of the Tariff Act, once the Secretary of the Treasury determines that a bounty or grant is in fact bestowed, expresses the view that the German practices and operations are currency manipulations and "that there is considerable doubt whether currency manipulations fall within the meaning of the term 'bounty or grant' as used in Section 303, and whether they may not more appropriately be regarded as a special form of currency depreciation." The proposed Decision of the Secretary of the Treasury after stating that "official reports and other data in the files of the Department establish to its satisfaction that bounties and/or grants are paid and/or bestowed, directly or indirectly," on exports from Germany to the United States of certain described dutiable articles, gives notice that "countervailing duties equal to any bounty and/or grant found to have been paid and/or

bestowed will be collected" thirty days after publication of the notice, and that at that time the liquidation of all entries covering such articles shall be suspended pending the declaration of the "bounty and/or grant determined or estimated to have been paid and/or bestowed, and the net amount of countervailing duties to be collected," a deposit of estimated countervailing duties being required at the time of entry. (underscoring supplied). It will be observed from the underscored words that even if the proposed Treasury Decision is issued, a finding that a bounty or grant in fact has been paid or bestowed still remains to be made with respect to any particular importation before declaration of the amount of the bounty or grant determined or estimated to have been paid and of the amount of countervailing duty therefore to be collected.

### III.

#### THE GERMAN PRACTICES ASSERTED BY THE TREASURY DEPARTMENT AND ITS VIEW THAT THEY CONSTITUTE BOUNTIES OR GRANTS.

(1) Payments of direct cash bounties by German industrial associations. The Treasury Department and the State Department are in agreement that if such cash bounties are paid, the law requires the imposition of countervailing duties. The German government has transmitted to the Department of State its formal denial that such cash bounties are being paid. The Treasury Department, however, states that it has evidence that such cash bounties are being paid. Clearly if such a cash bounty is paid in connection with any exportation from Germany, the law requires imposition of a countervailing duty and no further discussion on this point is necessary, only a question of fact being involved. The proposed Treasury Decision, aside from questions of policy, would be appropriate in its present form to meet any such cash bounties since under it a finding that such a cash bounty in fact has been paid on any particular shipment is still necessary.

(2) Scrip and Bond Procedures. German debtors are required to pay the interest and amortizations of the principal on certain foreign-owned German securities to a conversion bank which then pays to the owner of the security in currency one half of the amount due thereon, and the remaining one half in so-called "scrip" which is redeemable (but in reality only in theory) at its face value at some time in the future—but both the date and the probability of ultimate redemption are uncertain. The Gold Discount Bank, which is an agency of the German government, maintains a bid of fifty per cent of the face value of the "scrip". Because of the uncertainty of redemption, the foreign owners of the "scrip" usually prefer to sell it to the Gold Discount Bank for fifty per cent of its face value rather than risk a full loss by holding it for ultimate redemption.

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German exporters who otherwise would be unable to sell goods in the United States except at a loss are allowed, under special permits issued by German exchange control authorities, to use part of the proceeds received from a particular export transaction to purchase "scrip" from the Gold Discount Bank at a discount less than fifty per cent. Thereupon the particular exporter may present the "scrip" to the Conversion Bank and receive its full face value. The German authorities grant such special permits only if the current policy of the German government deems exportation of the goods desirable; and the amount of "scrip" so allowed to be purchased and redeemed in connection with the particular export is measured by the loss in the export sale which is intended to be off-set by this procedure.

Similarly the German exchange control authorities, when satisfied that an exporter will otherwise sustain a loss in a particular export sale, grant the exporter special permission to have part of the foreign exchange proceeds of the sale used for the purchase in the United States of German dollar bonds at the prevailing market price. Because of the disability of the foreign owners of such bonds respecting sale or redemption of them in Germany, such bonds sell in the United States at substantial discounts. However, when they are acquired as just indicated for the account of the German exporter, the bonds are redeemed at par by the Conversion Bank in Germany which handles the entire transaction of purchasing and redeeming the bonds. Here again this procedure is permitted only if the German exchange control authorities deem the particular exportation desirable and only such amount of bonds is permitted to be purchased as such authorities find to be necessary to off-set the loss on the export sale.

The Treasury Department takes the position that such "scrip" and bond transactions constitute grants to the German exporter by the German government because of the exportation of the German goods to the United States, and that the concession has a value which can be ascertained exactly in terms of United States currency. It asserts that the value of such concession is not paid for by the American purchaser and that it enables the German exporter to sell his goods more cheaply in the United States in competition with our domestic goods. It, therefore, concludes that such procedures constitute the bestowal of an indirect bounty or grant which the statute requires to be countervalled.

(5) Currency Manipulation. All German marks are of one class, having a nominal exchange value in American currency at the present time of approximately forty cents. However, the German government has established in Germany mark accounts under different names; but the character-

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istic of all such accounts for present purposes is the same, they are "controlled", "frozen" or "blocked" accounts. The funds in such accounts cannot be used for any purpose whatsoever without special permission of the German exchange control authorities. Hereafter for convenience the marks in such accounts will be referred to as "controlled marks" to distinguish them from uncontrolled marks in free circulation in Germany. The principal use of controlled marks is for payment for goods exported from Germany, the controlled funds being held in Germany for foreign account and the disposition and use of them by their foreign owners being restricted. However, it must continually be borne in mind that there is only one type of mark in Germany, whether it be in a controlled account or in free circulation.

By reason of the control exercised by the German government over such controlled mark accounts and its restriction over the disposition and use of them by their foreign owners, the market value of such marks has greatly depreciated. When a German exporter finds that he cannot meet competition in our markets under existing currency exchange conditions, he may apply to the exchange control authorities of Germany for permission to accept payment for particular exportations in whole or in part in controlled marks. If the authorities consider the particular exportation to be in accord with the current policy of the German government, the requested permission is granted. The American importer of German goods purchases controlled marks at their reduced values. The German exporter then receives either in full or part payment (as the German exchange control authorities determine) the controlled marks--whereupon such marks immediately become released from the control and are of the value of marks in free circulation in Germany.

The Treasury Department gives the following example to illustrate the device and effect of German export transactions involving use of the controlled mark: If the price to be received by the German exporter is one hundred marks and he has no permission from the German exchange control authorities to receive controlled marks in payment, the cost to the American importer will be approximately forty dollars, the value of the free mark being forty cents. If, however, the German exporter can compete advantageously in our market only if he is in a position to sell the goods for twenty eight dollars and the German authorities determine that a sale at that price should be facilitated, the German exporter may be permitted to receive full payment for the goods in controlled marks obtainable by the American importer for twenty eight cents per mark; or in the more usual case, permission may be granted to the exporter for the acceptance by him, say, of seventy five controlled marks obtainable by the American importer at twenty four cents per mark, and the balance of twenty five marks will be received by the German exporter in free marks costing the American importer forty cents each. Since the controlled marks immediately

become free marks in the hands of the German exporter, it is obvious that on final settlement the German exporter receives one hundred marks of the uniform value of forty cents each. In either case the American importer has paid twenty eight dollars for the goods and the German exporter has received one hundred marks worth forty dollars in our currency.

The Treasury Department asserts in respect of the above example that the only factors intervening between the American importer and the German exporter to effect this addition of value to the purchase between the payment and the receipt thereof are the acts of the German government; by these acts there is granted to a favored exporter of privileged German goods, because of their exportation to the United States, a concession valued in our money at twelve dollars, which enables the German exporter to sell his goods more cheaply in the United States in competition with our domestic products; and that the case is squarely within the purview of the law requiring the application of additional duties to countervail the grant bestowed upon the German exporter by the German government on exportation of the German goods.

The position of the Treasury Department is that the German exporter who is so paid in controlled marks receives a benefit measured by the difference between the prices paid by American importers for the controlled marks and for free marks. It asserts that the cost of this difference does not fall upon the American importer and that the value of the difference is granted by the German government to the German exporter because of the exportation of the goods--with the result that the German exporter is thereby enabled to sell his goods more cheaply in the United States in competition with our domestic goods. It does not consider relevant the fact that a benefit may also result to the American importer, stating that no bounty or grant can achieve its purpose without benefiting the purchaser through lowering the price to him of the "subsidized goods," and that a direct money payment by a foreign government to an American importer could be an indirect bounty on the exportation of the goods from the foreign country within the statute.

#### IV.

#### THE VIEW OF THE STATE DEPARTMENT THAT SUCH PRACTICES DO NOT CONSTITUTE BOUNTIES OR GRANTS.

In the summary of the opinion of the General Counsel for the Treasury Department, which was handed to the Attorney General by the President with the Secretary's letter, it is stated that "The facts

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are not in dispute and the statute is admittedly mandatory on the Secretary of the Treasury." I have pointed out heretofore that the Secretary of State admits that the Act is mandatory and in the sense that the practices used by Germany are substantially admitted by both Departments to exist, it is true that the facts are not in dispute. It is respecting the conclusions to be drawn from such facts that the divergence of view exists.

The State Department seriously fears that the application of countervailing duties to the scrip and bond procedures and to the currency manipulation described under III above will have deplorable repercussions upon our foreign trade, not only with Germany, but with other countries in Europe and in South America. If the currency manipulation used in Germany makes it necessary to impose countervailing duties upon her exports, the same will be true with respect to other countries employing the same practices. It believes that imposition of such duties will lead to ill feeling toward us by such nations and retaliation which will hurt both our import and export trade with them. It says that such action would be particularly unfortunate at present because of pending negotiations between the State Department and Germany concerning our insistence upon non-discriminatory treatment of American commerce in Germany, and because of our approaching conference at Buenos Aires with Latin-American countries. It is of the view that these currency procedures in Germany and other countries make possible trade between them and ourselves, that the purpose of such procedures is not to "dump" their goods here but merely to enable them to compete so that imposition of countervailing duties is not necessary; and that such action would largely defeat the objectives of our foreign trade program.

It will be appreciated that the views of the State Department described in the paragraph last above are directed to the policy of imposing countervailing duties rather than to the question whether they must be imposed under the statute in view of the practices under consideration. However, the State Department on the legal question takes the view that "There is considerable doubt whether currency manipulations fall within the meaning of the term 'bounty or grant' as used in Section 303, and whether they may not more appropriately be regarded as a special form of currency depreciation." In this view the State Department concurs with the Subcommittee on Countervailing Duties in Relation to Currency Problems in its report of March 28, 1936, to The Executive Committee on Commercial Policy. The Subcommittee concludes that the currency measures under consideration do not involve the payment or bestowal of a "bounty" so that the question is whether they constitute a "grant" within the meaning of Section 303. The Subcommittee then points out that since the Treasury Department has never invoked countervailing duties in cases of complete depreciation and apparently does not now contemplate such action, the word "grant" in the statute is not intended to cover cases

of complete depreciation, and states the crux of the problem to be "whether or not currency manipulation resulting from the use of a multiple currency system is so different in character and effect from a complete depreciation as to require countervailing action under a interpretation of the term 'grant' which does not require the application of such action in the case of complete depreciation."

The Subcommittee and also the State Department believe that currency manipulation should be regarded as a special case of currency depreciation and that there is, by reason of that fact, no essential difference, from the point of view of the application of Section 303, between depreciation and manipulation. It is argued that the Treasury Department has not at any time considered countervailing action against devaluation or depreciation as legally mandatory under Section 303, and nevertheless has never been seriously criticised or challenged on that score. It is deduced from this that the Treasury Department "has clearly applied Section 303 heretofore, with what appears to be full legal propriety, on the basis of a much narrower interpretation of the term 'grant' than is now proposed."

The Subcommittee, therefore, suggests (1) that the distinction between currency depreciation and currency manipulation, so far as Section 303 is concerned, "is one of method rather than of principle," (2) that an interpretation of "grant" which would exclude from the operation of Section 303 not only currency devaluation and depreciation, but also currency manipulation "would do no violence to either the letter or the spirit of the Section", and (3) that such an interpretation is not likely to subject the Treasury Department to any more serious criticism than its present procedure in not invoking Section 303 against devaluation and depreciation of foreign currencies.

It will be observed that so great is the concern of the State Department respecting the policy of imposing countervailing duties in the instances under consideration that it may be difficult for it to disassociate the question of policy from the question of legal construction in its approach to the latter.

#### V.

#### CONCLUSIONS AND RECOMMENDATIONS

I think that the concern of the State Department from the standpoint of economic policy in relation to our foreign trade is entirely justified. I have little doubt that if countervailing duties are imposed under Section 303 by reason of the practices under consideration, both our import and export trade with Germany would be adversely affected. If such duties are applied to shipments from

Germany, it is difficult to see how imposition of them on shipments from other countries using similar currency devices can be obviated. From the standpoint of policy, the situation demands the most careful consideration. However, if such practices fall within the contemplation of Section 303, the Secretary of the Treasury is under mandate to impose countervailing duties and only action by Congress in the interests of policy could relieve him of his obligation.

It is interesting to note that the Subcommittee on Countervailing Duties in Relation to Currency Problems admits that "generally speaking, the various devices appear to be operated in such a way as to enable the German exporter to sell his goods abroad at prices prevailing in the foreign markets in terms of the national currencies of those markets, which he is not able to do except on the basis of depreciated marks," and again "thus what happens under a multiple currency system is that for the purposes of the particular transactions involved, the currency of the exporting country may be considered as depreciated in exactly the same way as it would have been if the country had operated on the basis of complete and openly announced depreciation. Currency manipulation is in effect a condition of controlled depreciation and may serve either as a transitional procedure to open depreciation and final devaluation, or as a temporary device for avoiding a permanent alteration in the monetary system."

It seems to me obvious that the scrip and bond device and the currency manipulation devices are for the benefit of German exporters and enable them to export their goods so as to be in a position to compete with our domestic products, instead of exporting their goods to this country at a loss. Export transactions are completely controlled by the German government which permits only such exports as it deems to be in the German interest, and the devices are means by which the German government enables the German exporters to export without incurring a loss. In reality the assistance which the German exporter receives is financed by levies upon capital and income collected from foreign creditors of German debtors by the German government and paid over by it to the favored German exporters. It is true that the funds so used to aid the German exporters are not transmitted through the German treasury, but I do not see that that is material. I may add that the German authorities also completely control imports into Germany, permitting only those which are deemed for the benefit of that country. The Treasury Department states that to some extent the aid to German exporters is financed by levies collected from German importers. The whole policy appears to be to encourage exports from and discourage imports into Germany.

I have observed under II above how broad is the language of the statute requiring imposition of countervailing duties. While in all probability when that Act was passed the Congress did not have in mind the particular devices under consideration, as I have observed

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on page 5, the statute was plainly intended to anticipate as inclusively as possible all practices and devices which might be resorted to or invented to circumvent the statute by obscuring or concealing their purposes as bounties or grants. It has also been pointed out that the Supreme Court has noted the extent of its scope—"A word of broader significance than 'grant' could not have been used." Not only a direct bounty or grant, but one which is indirect is expressly comprehended by the statute, which in addition to referring to a bounty or grant directly or indirectly paid or bestowed, takes the precaution of adding "however the same be paid or bestowed."

I should have no doubt that the scrip and bond practices and also the currency manipulations constitute the payment or bestowal, directly or indirectly, of bounties and grants upon the German exports calling for the imposition by the Treasury Department of countervailing duties, plainly within the language of the Act "however the same be paid or bestowed"—unless it can be said that such practices are not within the Act because they are merely special forms of currency depreciation, and that currency depreciation whether complete or partial is not a bounty or grant within the Act. The difficulty with the latter position is that the practices are discriminatory for the express purpose of enabling German exporters to sell their goods here at prices prevailing in our markets, which they are not able to do except on the basis of such practices. This seems to be admitted in the report of the Subcommittee on Countervailing Duties in Relation to Currency Problems, as has been pointed out in the second paragraph on page 11, supra. The State Department seems to argue that since uniform depreciation or devaluation of German currency would not be within the Act, notwithstanding that it would stimulate exports from Germany to the United States to even a greater extent than the practices under consideration, therefore partial or special depreciation or devaluation, such as accomplished by the practices discussed, would not be within the Act. I do not believe that such conclusion follows from the premise upon which it is based. In the event of a complete or general depreciation or devaluation, there would be no discrimination between one exporter and another, or exporters as distinguished from importers, or other third parties.

Under the scrip and bond practices and the partial or special devaluation or depreciation practices (if the question is to be discussed in terms of currency devaluation or depreciation), the whole aim is to vest in the German government absolute control over exports: the determination of whether the particular export is to the best interests of Germany, the determination of how much depreciated currency is required by the exporter in order to enable him to place his goods in this country in competition with similar goods here, and the necessary manipulation to accomplish the end desired. The practices under discussion

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seem to fall very precisely within the language quoted on pages 3 and 4, supra, from the cases of Nicholas v. United States. The intent of the practices is to assist German exporters and the results carry out that intent. "However the same be paid or bestowed" it is plain that there is a bounty or grant paid or bestowed "directly or indirectly" by the German government which has established the machinery for the benefit of the German exporter and which assists him to operate it.

However, the field of currency depreciation, devaluation, and manipulation, especially in relation to foreign exchange, is abstruse and difficult of comprehension. For this reason, notwithstanding that what I have said would indicate that the practices under consideration are such as to require the imposition of countervailing duties by the Treasury Department, it is my recommendation that the question be very carefully considered further, both by the Secretary of the Treasury and the Secretary of State—and perhaps by them jointly with the President. It may be also that the views of the Secretary of Commerce should be obtained. The "facts" upon which any legal conclusion is to be premised are not only complex but in themselves are fraught with conclusions. Thus the facts are in a twilight zone of fact and conclusion in the foggy realm of currency and foreign exchange. It behooves the legal traveller in that domain to proceed cautiously and with the greatest circumspection. Even should it be determined that the law requires the imposition of countervailing duties, it may be that it should be determined at the same time whether, if that be true, the law should be changed because of its adverse effect as a matter of policy upon our foreign trade relations.

Respectfully,

  
GOLDEN W. BELL,  
Assistant Solicitor General.

ALBERT W. BELL  
Assistant Solicitor General

DEPARTMENT OF JUSTICE  
Washington

April 30, 1936

MEMORANDUM FOR THE ATTORNEY GENERAL

Re: Proposed Treasury Decision Giving Notice of the Imposition of Countervailing Duties on Certain Imports from Germany under Section 303 of the Tariff Act of 1930.

I.

REFERENCE TO AID STEPS TAKEN BY THE ATTORNEY GENERAL

On April 17, the President handed to the Attorney General a Report and Recommendation<sup>a</sup> a letter respecting the above subject from the Secretary of the Treasury to the President, dated April 16, 1936, together with a summary of the opinion of the General Counsel for the Treasury Department, dated April 15, 1936, and a copy of a letter to the Secretary from the Secretary of State, dated April 2, 1936, enclosing copy of a confidential report to The Executive Committee on Commercial Policy from the Subcommittee on Countervailing Duties in Relation to Currency Problems, dated March 28, 1936. On the same day the Attorney General assigned the matter to the Assistant Solicitor General.

Upon a study of the documents received from the President, it was found that neither a copy of the proposed Treasury Decision, nor of the opinion of the General Counsel for the Treasury Department accompanied the documents transmitted to the Attorney General, and that without them no sufficient factual basis existed upon which the requested report and recommendation could be made. It was also obvious that a divergence of view respecting the proposed imposition of countervailing duties obtained as between the Secretary of the Treasury and the Secretary of State. For these reasons, on April 16, 1936, the Attorney General advised the Secretary of the Treasury and the Secretary of State of the President's request for report and recommendation, asking the former for the missing documents and affording the latter an opportunity to present such additional views as he might care to submit.

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1936, the Secretary of State welcomed the opportunity of submitting his views through conference between his legal adviser and a foreign exchange expert with representatives of this Department. Since receipt of these communications from the respective Secretaries, conferences have been held with the representatives of each and the matter has been given our careful consideration. The endeavor will be made in this memorandum to present to the Attorney General as briefly as possible the existing situation, the divergent views of the Treasury Department and the State Department, and the conclusions at which I have arrived. It would serve no purpose to attempt here to restate the more detailed position of the Treasury Department set out in the opinion of its General Counsel to the Secretary, dated April 15, 1936, which is attached for reference; or that of the State Department in the annexed letter from Secretary Hall to Secretary Morgenthau, dated April 2, 1936,--which is expected to be supplemented by a further memorandum under preparation in the State Department, which will be attached.

I may state at the outset that because of the important questions of foreign policy involved and the conflict between the views of the Treasury Department and those of the State Department, I think that it will be advisable for the Attorney General to confer personally with the President on the problem, and I anticipate that the President may also wish to hear the two Secretaries before resolving the question.

II.

THE QUESTION AND THE CONSTRUCTION OF THE DUTY ACT OF 1930 UPON WHICH DEPENDS THE ANSWER.

Briefly, the question is whether Germany, through certain duties, must be held under Section 303 of the Tariff Act of 1930 to pay or bestow, directly or indirectly, any bounty or grant upon the manufacture or production or export of certain dutiable articles or merchandise manufactured or produced in that country. If so, the Act provides that upon importation of such articles into the United States there shall be levied and paid, in all such cases, in addition to the duties otherwise imposed by this Act, an additional duty equal to the net amount of such bounty or grant, however the same be paid or bestowed. The Act requires that "the Secretary of the Treasury shall from time to time ascertain and determine, or estimate, the net amount of each such bounty or grant, and shall declare the net amount so determined or estimated," empowering him to make all regulations which he may deem necessary for identifying such articles and assessing and collecting such additional duties. It will thus be observed that the duties of the Secretary of the Treasury under the Act are mandatory. Therefore, if in fact Germany does "pay or bestow, directly or indirectly, any

bounty or grant upon the manufacture or production or export of such articles, the Secretary must levy and collect "an additional duty equal to the net amount of such bounty or grant, however the same be paid or bestowed." The inquiry is whether the practices being pursued by Germany respecting exports to this country constitute bounties or grants within the comprehensive language of the statute which has been indicated above by underscoring. It is obvious from the language itself that the scope of the Act is very broad, and the Supreme Court has said of it that:

The statute was addressed to a condition and its words must be considered as intending to define it, and all of them--"grant" as well as "bounty"-- must be given effect. If the word "bounty" has a limited sense the word "grant" has not. A word of broader significance than "grant" could not have been used. Like its synonyms "give" and "bestow," it expresses a concession, the conferring of something by one person upon another. And if the "something" be conferred by a country "upon the exportation of any article or merchandise" a countervailing duty is required by Paragraph E. Nicholas v. United States, 249 U.S. 34.

I think it plain from the statute itself that it was intended to anticipate as inclusively as possible all practices and devices which might be resorted to or invented to circumvent the statute by obscuring or concealing their purposes as bounties or grants. The history of the Act fully corroborates its purpose to make impossible its evasion by indirection or disguise. In the case of Nicholas v. United States, *supra*, Great Britain paid certain amounts as "compensation" in addition to the remission of inland revenue taxes upon exportation of liquor to the United States. Countervailing duties equal to the net amount of the "compensation" were imposed and the imposition was sustained by the Court, which after using the language quoted above said:

We have the fact of spirits able to be sold cheaper in the United States than in the place of their production, and this the result of an act of government because of the destination of the spirits being a foreign market. For that situation Paragraph E was intended to provide.

In an earlier decision in the same case (Nicholas v. United States, 7 Ct. Cust. Appls. 97), the Court of Customs Appeals after commenting upon the clarity of the language and purpose of the statute said:

Whenever a foreign power or dependency or any political subdivision of a government shall give any aid or advantage to exporters of goods imported into

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this country therefrom whereby they may be sold for less in competition with our domestic goods, to that extent by this paragraph (3) the duties fixed in the schedule of the act are increased. It was a result Congress was seeking to equalize regardless of whatever name or in whatever manner or form or for whatever purpose it was done.

In reply to the contention that the "compensation" was a reimbursement of extra costs imposed on the goods by British excise regulations, the Court of Customs Appeals said:

The fact that the payment made by the foreign government was estimated or calculated upon a basis or in consideration of extra burdens imposed by domestic excise laws, or for any other reason of domestic government or policy commending itself to the wisdom of Parliament is not controlling with our courts. The sole inquiry is, do the results of such acts stimulate exportation or give a special advantage by affording aid from the public treasury whereby such goods may when exported be sold in competition with ours for less.

With this construction of the Act in mind, it remains to determine whether the practices and operations of the German government with respect to exports to this country constitute bounties or grants requiring the imposition of countervailing duties. The Secretary of the Treasury in his letter to the President says, "I am satisfied that, under the circumstances, I have no choice but to sign and issue this Treasury Decision." The Secretary of State in his letter to Secretary Morgenthau expresses great concern at the latter's conclusion, particularly from the standpoint of economic policy in our trade relations with Germany; and while fully recognizing the mandatory nature of Section 303 of the Tariff Act, once the Secretary of the Treasury determines that a bounty or grant is in fact bestowed, expresses the view that the German practices and operations are currency manipulations and "that there is considerable doubt whether currency manipulations fall within the meaning of the term 'bounty or grant' as used in Section 303, and whether they may not more appropriately be regarded as a special form of currency depreciation." The proposed Decision of the Secretary of the Treasury after stating that "official reports and other data in the files of the Department establish to its satisfaction that bounties and/or grants are paid and/or bestowed, directly or indirectly," on exports from Germany to the United States of certain described dutiable articles, gives notice that "countervailing duties equal to any bounty and/or grant found to have been paid and/or

bestowed will be collected" thirty days after publication of the notice, and that at that time the liquidation of all entries covering such articles shall be suspended pending the declaration of the "bounty and/or grant determined or estimated to have been paid and/or bestowed, and the net amount of countervailing duties to be collected," a deposit of estimated countervailing duties being required at the time of entry. (underscoring supplied). It will be observed from the underscoring words that even if the proposed Treasury Decision is issued, a finding that a bounty or grant in fact has been paid or bestowed still remains to be made with respect to any particular importation before declaration of the amount of the bounty or grant determined or estimated to have been paid and of the amount of countervailing duty therefore to be collected.

## III.

THE GERMAN PRACTICES ASSERTED BY THE TREASURY DEPARTMENT  
AND ITS VIEW THAT THEY CONSTITUTE BOUNTIES ON GRANTS.

(1) Payments of direct cash bounties by German industrial Associations. The Treasury Department and the State Department are in agreement that if such cash bounties are paid, the law requires the imposition of countervailing duties. The German government has transmitted to the Department of State its formal denial that such cash bounties are being paid. The Treasury Department, however, states that it has evidence that such cash bounties are being paid. Clearly if such a cash bounty is paid in connection with any exportation from Germany, the law requires imposition of a countervailing duty and no further discussion on this point is necessary, only a question of fact being involved. The proposed Treasury Decision, aside from questions of policy, would be appropriate in its present form to meet any such cash bounties since under it a finding that such a cash bounty in fact has been paid on any particular shipment is still necessary.

(2) Scrip and Bond Procedures. German debtors are required to pay the interest and amortizations of the principal on certain foreign-owned German securities to a conversion bank which then pays to the owner of the security in currency one half of the amount due thereon, and the remaining one half in so-called "scrip" which is redeemable (but in reality only in theory) at its face value at some time in the future--but both the date and the probability of ultimate redemption are uncertain. The Gold Discount Bank, which is an agency of the German government, maintains a bid of fifty per cent of the face value of the "scrip". Because of the uncertainty of redemption, the foreign owners of the "scrip" usually prefer to sell it to the Gold Discount Bank for fifty per cent of its face value rather than risk a full loss by holding it for ultimate redemption.

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German exporters who otherwise would be unable to sell goods in the United States except at a loss are allowed, under special permits issued by German exchange control authorities, to use part of the proceeds received from a particular export transaction to purchase "scrip" from the Gold Discount Bank at a discount less than fifty per cent. Thereupon the particular exporter may present the "scrip" to the Conversion Bank and receive its full face value. The German authorities grant such special permits only if the current policy of the German government deems exportation of the goods desirable; and the amount of "scrip" so allowed to be purchased and redeemed in connection with the particular export is measured by the loss in the export sale which is intended to be off-set by this procedure.

Similarly the German exchange control authorities, when satisfied that an exporter will otherwise sustain a loss in a particular export sale, grant the exporter special permission to have part of the foreign exchange proceeds of the sale used for the purchase in the United States of German dollar bonds at the prevailing market price. Because of the disability of the foreign owners of such bonds respecting sale or redemption of them in Germany, such bonds sell in the United States at substantial discounts. However, when they are acquired as just indicated for the account of the German exporter, the bonds are redeemed at par by the Conversion Bank in Germany which handles the entire transaction of purchasing and redeeming the bonds. Here again this procedure is permitted only if the German exchange control authorities deem the particular exportation desirable and only such amount of bonds is permitted to be purchased as such authorities find to be necessary to off-set the loss on the export sale.

The Treasury Department takes the position that such "scrip" and bond transactions constitute grants to the German exporter by the German government because of the exportation of the German goods to the United States, and that the concession has a value which can be ascertained exactly in terms of United States currency. It asserts that the value of such concession is not paid for by the American purchaser and that it enables the German exporter to sell his goods more cheaply in the United States in competition with our domestic goods. It, therefore, concludes that such procedures constitute the bestowal of an indirect bounty or grant which the statute requires to be countervalled.

(3) Currency Manipulation. All German marks are of one class, having a nominal exchange value in American currency at the present time of approximately forty cents. However, the German government has established in Germany mark accounts under different names; but the character-

istic of all such accounts for present purposes is the same,—they are "controlled", "frozen" or "blocked" accounts. The funds in such accounts cannot be used for any purpose whatsoever without special permission of the German exchange control authorities. Hereafter for convenience the marks in such accounts will be referred to as "controlled marks" to distinguish them from uncontrolled marks in free circulation in Germany. The principal use of controlled marks is for payment for goods exported from Germany, the controlled funds being held in Germany for foreign account and the disposition and use of them by their foreign owners being restricted. However, it must continually be borne in mind that there is only one type of mark in Germany, whether it be in a controlled account or in free circulation.

By reason of the control exercised by the German government over such controlled mark accounts and its restriction over the disposition and use of them by their foreign owners, the market value of such marks has greatly depreciated. When a German exporter finds that he cannot meet competition in our markets under existing currency exchange conditions, he may apply to the exchange control authorities of Germany for permission to accept payment for particular exportations in whole or in part in controlled marks. If the authorities consider the particular exportation to be in accord with the current policy of the German government, the requested permission is granted. The American importer of German goods purchases controlled marks at their reduced values. The German exporter then receives either in full or part payment (as the German exchange control authorities determine) the controlled marks—whereupon such marks immediately become released from the control and are of the value of marks in free circulation in Germany.

The Treasury Department gives the following example to illustrate the device and effect of German export transactions involving use of the controlled marks. If the price to be received by the German exporter is one hundred marks and he has no permission from the German exchange control authorities to receive controlled marks in payment, the cost to the American importer will be approximately forty dollars, the value of the free mark being forty cents. If, however, the German exporter can compete advantageously in our market only if he is in a position to sell the goods for twenty eight dollars and the German authorities determine that a sale at that price should be facilitated, the German exporter may be permitted to receive full payment for the goods in controlled marks obtainable by the American importer for twenty eight cents per mark; or in the more usual case, permission may be granted to the exporter for the acceptance by him, say, of seventy five controlled marks obtainable by the American importer at twenty four cents per mark, and the balance of twenty five marks will be received by the German exporter in free marks costing the American importer forty cents each. Since the controlled marks immediately

become free marks in the hands of the German exporter, it is obvious that on final settlement the German exporter receives one hundred marks of the uniform value of forty cents each. In either case the American importer has paid twenty eight dollars for the goods and the German exporter has received one hundred marks worth forty dollars in our currency.

The Treasury Department asserts in respect of the above example that the only factors intervening between the American importer and the German exporter to effect this addition of value to the purchase between the payment and the receipt thereof are the acts of the German government; by these acts there is granted to a favored exporter of privileged German goods, because of their exportation to the United States, a concession valued in our money at twelve dollars, which enables the German exporter to sell his goods more cheaply in the United States in competition with our domestic products; and that the case is squarely within the purview of the law requiring the application of additional duties to countervail the grant bestowed upon the German exporter by the German government on exportation of the German goods.

The position of the Treasury Department is that the German exporter who is so paid in controlled marks receives a benefit measured by the difference between the prices paid by American importers for the controlled marks and for free marks. It asserts that the cost of this difference does not fall upon the American importer and that the value of the difference is granted by the German government to the German exporter because of the exportation of the goods--with the result that the German exporter is thereby enabled to sell his goods more cheaply in the United States in competition with our domestic goods. It does not consider relevant the fact that a benefit may also result to the American importer, stating that no bounty or grant can achieve its purpose without benefiting the purchaser through lowering the price to him of the "subsidized goods", and that a direct money payment by a foreign government to an American importer could be an indirect bounty on the exportation of the goods from the foreign country within the statute.

#### IV.

#### THE VIEW OF THE STATE DEPARTMENT THAT SUCH PRACTICES DO NOT CONSTITUTE BOUNTIES OR GRANTS.

In the summary of the opinion of the General Counsel for the Treasury Department, which was handed to the Attorney General by the President with the Secretary's letter, it is stated that "The facts

are not in dispute and the statute is admittedly mandatory on the Secretary of the Treasury." I have pointed out heretofore that the Secretary of State admits that the Act is mandatory and in the sense that the practices used by Germany are substantially admitted by both Departments to exist, it is true that the facts are not in dispute. It is respecting the conclusions to be drawn from such facts that the divergence of view exists.

The State Department seriously fears that the application of countervailing duties to the scrip and bond procedures and to the currency manipulation described under III above will have deplorable repercussions upon our foreign trade, not only with Germany, but with other countries in Europe and in South America. If the currency manipulation used in Germany makes it necessary to impose countervailing duties upon her exports, the same will be true with respect to other countries employing the same practices. It believes that imposition of such duties will lead to ill feeling toward us by such nations and retaliation which will hurt both our import and export trade with them. It says that such action would be particularly unfortunate at present because of pending negotiations between the State Department and Germany concerning our insistence upon non-discriminatory treatment of American commerce in Germany, and because of our approaching conference at Buenos Aires with Latin-American countries. It is of the view that these currency procedures in Germany and other countries make possible trade between them and ourselves, that the purpose of such procedures is not to "dump" their goods here but merely to enable them to compete so that imposition of countervailing duties is not necessary; and that such action would largely defeat the objectives of our foreign trade program.

It will be appreciated that the views of the State Department described in the paragraph last above are directed to the policy of imposing countervailing duties rather than to the question whether they must be imposed under the statute in view of the practices under consideration. However, the State Department on the legal question takes the view that "There is considerable doubt whether currency manipulations fall within the meaning of the term 'bounty or grant' as used in Section 303, and whether they may not more appropriately be regarded as a special form of currency depreciation." In this view the State Department concurs with the Subcommittee on Countervailing Duties in Relation to Currency Problems in its report of March 25, 1936, to The Executive Committee on Commercial Policy. The Subcommittee concludes that the currency measures under consideration do not involve the payment or bestowal of a "bounty" so that the question is whether they constitute a "grant" within the meaning of Section 303. The Subcommittee then points out that since the Treasury Department has never invoked countervailing duties in cases of complete depreciation and apparently does not now contemplate such action, the word "grant" in the statute is not intended to cover cases

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of complete depreciation, and states the crux of the problem to be "whether or not currency manipulation resulting from the use of a multiple currency system is so different in character and effect from a complete depreciation as to require countervailing action under an interpretation of the term 'grant' which does not require the application of such action in the case of complete depreciation."

The Subcommittee and also the State Department believe that currency manipulation should be regarded as a special case of currency depreciation and that there is, by reason of that fact, no essential difference, from the point of view of the application of Section 303, between depreciation and manipulation. It is argued that the Treasury Department has not at any time considered countervailing action against devaluation or depreciation as legally mandatory under Section 303, and nevertheless has never been seriously criticized or challenged on that score. It is deduced from this that the Treasury Department "has clearly applied Section 303 heretofore, with what appears to be full legal propriety, on the basis of a much narrower interpretation of the term 'grant' than is now proposed."

The Subcommittee, therefore, suggests (1) that the distinction between currency depreciation and currency manipulation, so far as Section 303 is concerned, "is one of method rather than of principle," (2) that an interpretation of 'grant' which would exclude from the operation of Section 303 not only currency devaluation and depreciation, but also currency manipulation "would do no violence to either the letter or the spirit of the Section", and (3) that such an interpretation is not likely to subject the Treasury Department to any more serious criticism than its present procedure in not invoking Section 303 against devaluation and depreciation of foreign currencies.

It will be observed that so great is the concern of the State Department respecting the policy of imposing countervailing duties in the instances under consideration that it may be difficult for it to disassociate the question of policy from the question of legal construction in its approach to the latter.

V.

#### CONCLUSIONS AND RECOMMENDATIONS

I think that the concern of the State Department from the standpoint of economic policy in relation to our

foreign trade is entirely justified. I have little doubt that if countervailing duties are imposed under Section 303 by reason of the practices under consideration, both our import and export trade with Germany would be adversely affected. If such duties are applied to shipments from Germany, it is difficult to see how imposition of them on shipments from other countries using similar currency devices can be obviated. From the standpoint of policy, the situation demands the most careful consideration. However, if such practices fall within the contemplation of Section 303, the Secretary of the Treasury is under mandate to impose countervailing duties and only action by Congress in the interests of policy could relieve him of his obligation.

It is interesting to note that the Subcommittee on Countervailing Duties in Relation to Currency Problems admits that "generally speaking, the various devices appear to be operated in such a way as to enable the German exporter to sell his goods abroad at prices prevailing in the foreign markets in terms of the national currencies of those markets, which he is not able to do except on the basis of depreciated marks," and again "thus what happens under a multiple currency system is that for the purposes of the particular transactions involved, the currency of the exporting country may be considered as depreciated in exactly the same way as it would have been if the country had operated on the basis of complete and openly announced depreciation. Currency manipulation is in effect a condition of controlled depreciation and may serve either as a transitorial procedure to open depreciation and final devaluation, or as a temporary device for avoiding a permanent alteration in the monetary system."

It seems to me obvious that the scrip and bond device and the currency manipulation devices are for the benefit of German exporters and enable them to export their goods so as to be in a position to compete with our domestic products, instead of exporting their goods to this country at a loss. Export transactions are completely controlled by the German government which permits only such exports as it deems to be in the German interest, and the devices are means by which the German government enables the German exporters to export without incurring a loss. In reality the assistance which the German exporter receives is financed by levies upon capital and income collected from foreign creditors of German debtors by the German government and paid over by it to the favored German exporters. It is true that the funds so used to aid the German exporters are not transmitted through the German treasury, but I do not see that that is material. I may add that the German authorities also completely control imports into Germany, permitting only those which are deemed for the benefit of that country. The Treasury Department states

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that to some extent the aid to German exporters is financed by levies collected from German importers. The whole policy appears to be to encourage exports from and discourage imports into Germany.

I have observed under 11 above how broad is the language of the statute requiring imposition of countervailing duties. While in all probability when that Act was passed the Congress did not have in mind the particular devices under consideration, as I have observed on page 3, the statute was plainly intended to anticipate as inclusively as possible all practices and devices which might be resorted to or invented to circumvent the statute by obscuring or concealing their purposes as bounties or grants. It has also been pointed out that the Supreme Court has noted the extent of its scope--"A word of broader significance than 'grant' could not have been used." Not only a direct bounty or grant, but one which is indirect is expressly comprehended by the statute, which in addition to referring to a bounty or grant directly or indirectly paid or bestowed, takes the precaution of adding "however the same to be paid or bestowed."

I should have no doubt that the scrip and bond practices and also the currency manipulations constitute the payment or bestowal, directly or indirectly, of bounties and grants upon the German exports calling for the imposition by the Treasury Department of countervailing duties, plainly within the language of the Act "however the same be paid or bestowed"-- unless it can be said that such practices are not within the Act because they are merely special forms of currency depreciation and that currency depreciation whether complete or partial is not a bounty or grant within the Act. The difficulty with the latter position is that the practices are discriminatory for the express purpose of enabling German exporters to sell their goods here at prices prevailing in our markets, which they are not able to do except on the basis of such practices. This seems to be admitted in the report of the Subcommittee on Countervailing Duties in Relation to Currency Problems, as has been pointed out in the second paragraph on page 11, supra. The State Department seems to argue that since uniform depreciation or devaluation of German currency would not be within the Act, notwithstanding that it would stimulate exports from Germany to the United States to even a greater extent than the practices under consideration, therefore partial or special depreciation or devaluation, such as accomplished by the practices discussed, would not be within the Act. I do not believe that such conclusion follows from the premise upon which it is based. In the event of a complete or general depreciation or devaluation, there would be no discrimination between one exporter and another, or exporters as distinguished from importers, or other third parties.

TREASURY DEPARTMENT  
Accounts and Deposits

To The Secretary

I am having matter  
of \$160<sup>00</sup> for Adjusted Service  
in f. y. 1937 checked. It  
may have effect of  
reducing deficit in 1937  
by that amount. If  
no deficit would then be  
\$2515.7<sup>00</sup>

WCB

MR. BELL

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Under the scrip and bond practices and the partial or special devaluation or depreciation practices (if the question is to be discussed in terms of currency devaluation or depreciation), the whole aim is to vest in the German government absolute control over exports: the determination of whether the particular export is to the best interests of Germany, the determination of how much depreciated currency is required by the exporter in order to enable him to place his goods in this country in competition with similar goods here, and the necessary manipulation to accomplish the end desired. The practices under discussion seem to fall very precisely within the language quoted on pages 3 and 4, supra, from the cases of Nicholas v. United States. The intent of the practices is to assist German exporters and the results carry out that intent. "However the same be paid or bestowed "directly or indirectly" by the German government which has established the machinery for the benefit of the German exporter and which assists him to operate it.

However, the field of currency depreciation, devaluation, and manipulation, especially in relation to foreign exchange, is abstruse and difficult of comprehension. For this reason, notwithstanding that what I have said would indicate that the practices under consideration are such as to require the imposition of countervailing duties by the Treasury Department, it is my recommendation that the question be very carefully considered further, both by the Secretary of the Treasury and the Secretary of State-- and perhaps by them jointly with the President. It may be also that the views of the Secretary of Commerce should be obtained. The "facts" upon which any legal conclusion is to be premised are not only complex but in themselves are fraught with conclusions. Thus the facts are in a twilight zone of fact and conclusion in the foggy realm of currency and foreign exchange. It behooves the legal traveller in that domain to proceed cautiously and with the greatest circumspection. Even should it be determined that the law requires the imposition of countervailing duties, it may be that it should be determined at the same time whether, if that be true, the law should be changed of its adverse effect as a matter of policy upon our foreign trade relations.

Respectfully,

GOLDEN W. BELL,  
Assistant Solicitor General.

*Done*  
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DEFICITS FOR FISCAL YEARS 1936 and 1937 BASED  
UPON ESTIMATES CONTAINED IN THE 1937 BUDGET SUBMIT-  
TED TO THE CONGRESS ON JANUARY 3, 1936, ADJUSTED  
BECAUSE OF THE AAA DECISION, PASSAGE OF THE  
ADJUSTED COMPENSATION ACT AND ON THE BASIS  
OF THE PENDING TAX BILL

Fiscal Year 1936

Budget deficit . . . . .	\$3,234.5	N
Adjusted expenditures due to AAA decision . . . . .	495.1	
	<u>          </u>	
	\$3,729.6	
Add: Veterans bonds to be issued . . . . .	2,237.0	
	<u>          </u>	
Total estimated deficit f. y. 1936 assuming Veterans bonds all to be issued this fiscal year.	\$5,966.6	
	<u>          </u>	

Fiscal Year 1937

Budget deficit . . . . .	\$1,096.4	
Add relief appropriation pending . . . . .	1,500.	
	<u>          </u>	
	\$2,596.4	
Adjust expenditures due to AAA decision. . . . .	524.3	
Deduct estimated revenue in pending bill . . . . .	490.	
	<u>          </u>	
	34.3	
Add refunds of taxes provided for in pending tax bill . . . . .	43.	
	<u>          </u>	
	77.3	
Adjusted deficit for fiscal year 1937:	\$ 2,675.7	
	<u>          </u>	

April 30, 1936.

April 30, 1936

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Under date of April 28, the New York Times reported that Poland had placed a ban on gold exports and had issued a decree that all dealings in foreign exchange will be controlled by a special committee of the Bank of Poland. (Clipping is attached.)

Today the Polish Embassy called, asking for an appointment with the Secretary for its Financial Counselor, Mr. Janusz Zoltowski. He came in at 1:45.

He said to the Secretary, "The Minister of the Treasury in Poland asked me to come in to see you. A few days ago we were forced to make the restrictions. The Minister of Finance is and always will be against these restrictions. This was done because of the European financial situation, because all this feeling about France will go off gold. We face this situation and if the restrictions were not done at once, in a few weeks we would not have a penny of gold. (1) Now this restriction is very partial to our bondholders. The payment of the interest on foreign debts will be continued.

HM, Jr.: You mean private debts. For instance, if an American holds a Polish bond, you will continue to pay interest on it.

Mr. Zoltowski: (2) That imports will not be affected at all. We buy a lot of goods, most of all cotton.

(3) The restrictions are partial, because we do not force the people to give up gold on each side of the country. I think if the French situation will be a little more clarified, it will help us.

HM, Jr.: Up to now your currency has been more or less tied to the French currency?

Mr. Zoltowski: Yes.

HM, Jr.: Your country has not been on gold, just like France, Belgium and Switzerland? Gold has not moved as freely in and out of your country?

Mr. Zoltowski: Oh, yes; it has.

HM, Jr.: Here in our Treasury we do not take any particular interest in private debts of our citizens. The State Department follows that. I do not. I am naturally interested in any Government move in connection with its currency

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on account of the general effect it has on world currencies. I would like you to sit down with Mr. Taylor and Mr. Lochhead and explain more fully what your position is today. Give us your figures as to your monetary reserves, etc., if you care to. That would interest me very much. I take it that once France decides, you will peg (??) your currency to that of France.

Mr. Zoltowski: We are very anxious to see general stabilization in the world.

HM, Jr.: So am I interested. If you know of any way that we can be helpful, I wish you would let us know.

(Mr. Taylor, who had been attending the wedding of the daughter of Mr. Dunn, of the State Department, came in to join the meeting. It appeared that Mr. Zoltowski and Mr. Taylor were acquainted with each other.)

Mr. Morgenthau said he would like to have Mr. Taylor, Mr. Lochhead and Mr. Zoltowski to go into further conference. Before the Minister left, Mr. Morgenthau again said, "We are interested in anything we can do legitimately to help any country stabilize. The more countries that we can be helpful to, the nearer we are to world stabilization." He asked Mr. Zoltowski if Germany offers much competition to Poland for world trade, for export and Mr. Zoltowski replied, "No." HM, Jr. then asked him, "Who do you go up against in the world's market? Who is your biggest competitor?" Mr. Zoltowski answered, "It is very difficult. Our biggest market is England." Mr. Morgenthau wanted to know what they sold to England and Mr. Zoltowski said, "Bacon, ham, eggs and malt." Mr. Morgenthau then commented, "Your relationship then to the £ Sterling is important?" and Mr. Zoltowski answered "Yes."

Mr. Zoltowski, Mr. Taylor and Mr. Lochhead went to Mr. Taylor's office for further discussion.

April 28, 1936

## POLAND PUTS BAN ON GOLD EXPORTS

Quits French Bloc in Setting  
Up Exchange Control to End  
Big Losses of Money.

### FOREIGN LOANS TO BE PAID

Stocks Rise in Warsaw as the  
Deflationary Regime Ends  
—Hoarding a Problem.

Wireless to The New York Times.  
WARSAW, April 27.—Foreign exchange control and an embargo on gold exports were decreed this morning by President Ignacy Mościcki. The zloty is still technically on the gold standard, and the government strongly denies all rumors of devaluation, but in fact Polish currency has joined the group of controlled currencies, like the mark and lira.

All dealings in foreign exchange will be controlled by a special committee of the Bank of Poland. Exportation of foreign money as well as of Polish money is prohibited. Only a few banks are allowed to deal in foreign exchange at an official rate under this committee's supervision, and all money in gold from foreign business transactions must be offered to the Bank of Poland.

Purchasing of foreign stocks or bonds, whether industrial or governmental, is prohibited. The decree introduces "blocked" deposit accounts for foreign firms, into which all sums due are to be paid. Permission to transfer these sums abroad will be given by the committee.

A maximum of 500 zloty will be allowed to residents of Poland going abroad, for the purchase of foreign currency.

In a declaration issued with the decree the government justifies its decision with the fact that during the last few weeks mass purchases of gold and foreign currencies for hoarding have drained the reserves of the Bank of Poland and led to withdrawals of bank deposits. All foreign loans will be paid normally.

#### Action Was Immediate

News of the currency control was announced this morning and dealings in foreign money were sus-

sended immediately. Financial circles think this decree was inevitable as the only way to halt the outflow of gold. It was calculated that following the anti-Jewish riots last Winter, the recent disturbances at Cracow and Lwow and the rumore of a government crisis, money to the value of \$2,000,000 was dispatched weekly to the Netherlands, where pre-war czarist gold rubles were being minted especially on Polish orders.

Large sums of money also went to Palestine with Jewish emigrants, who have been leaving this country at the rate of 2,000 monthly.

The gold holdings of the Bank of Poland for the second ten-day period in April decreased 10,000,000 zloty to 417,000,000 and foreign exchange bills by 2,000,000 zloty to 15,000,000.

With the money in circulation at 942,000,000 zloty, the gold coverage is still 40 per cent. A year ago the gold reserve was 527,000,000 zloty. During the last two months the Bank of Poland lost 50,000,000 zloty, or more than 10 per cent of its holdings. The gold dollar rose from 9.90 to 9.20 zloty.

Today's decree is regarded in financial circles as the beginning of the end of the rigid deflationary régime which has been the cornerstone of Poland's financial policy since 1930. Foreign exchange control, which is expected rapidly to replenish the Bank of Poland's gold holdings, will permit credit extension and divert capital from boards to industrial investments. Already, on today's Bourse, industrial stocks and government obligations have risen sharply.

#### Defection From the Franc

The gold decree of the Polish Government represent a further step in its efforts to stimulate business. Both the Warsaw government and the Bank of Poland have followed a consistent deflationary policy, but all efforts apparently have failed to bring about a business revival, bankers close to the situation point out.

While the embargo on gold exports and speculation technically constituted abandonment of the gold standard, the restrictions were not as drastic as those imposed by other nations which have left the gold bloc group.

However, Poland's action marks the first defection from the nations that have tied to the French franc, and, according to foreign exchange experts, may have the effect of speeding abandonment by France of

the gold standard. Only four European nations now on gold permit free exchange of the metal. They are France, the Netherlands, Belgium and Switzerland.

The situation in Poland apparently is much more difficult than any figures would indicate, since funds in great amounts have been frozen in exchange and clearing regulations. Only last week a joint statement by the President, the Premier and the head of the Bank of Poland denied any intention of devaluation or change in the nation's monetary policy. Since then, the loss in reserves by the central bank has been enormous, it is understood.

#### Decline in Holdings

At the end of 1934 the gold reserves of the bank amounted to 503,000,000 zloty, or a ratio of 44.8 per cent. A year later the ratio dropped to 39.7 per cent and, although the ratio on March 31, 1936, had bounded up to 41.3 per cent, the reserves were only 417,000,000 zloty, due to a decline in note circulation. Where formerly the legal requirement was 40 per cent reserves per 100,000,000 zloty, in recent years it has been dropped to 30 per cent.

The plight of Poland probably is best exemplified by the decline in her active trade balances. For the full year of 1931 they amounted to 410,000,000 zloty, or about \$79,000,000. The visible balances dropped to 179,000,000 zloty for 1934 and to 68,000,000 zloty for 1935. For January of the current year they amounted to only 5,000,000 zloty, as against 15,000,000 for the same month of 1935.

April 30, 1936

HM, Jr. spoke to the President today at 9:25. He told the President, "I have just talked to Cochran, in Paris. He says he thinks the thing is worse than what it seems. There is tremendous selling of securities; that they are putting it all in currency. He thinks the swing to the left is going to be even more than people believe. The chances are that the Cabinet will fall Monday and that Reynaud will go in and form a devaluation cabinet. I am calling Cochran again tomorrow morning at this time."

Thursday  
April 30, 1936

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H. M.  
Cochran: Hello -

HMjr: Hello, Cochran?

C: Yes

HMjr: Can you hear me?

C: Yes, very well, sir.

HMjr: Now, what I'd like you to do is to go over to Berlin and see your particular friend over there -

C: Yes

HMjr: Now, I don't know - you know better than I whether you could go tonight and be back by Sunday or whether you'd think you ought to wait and not go until next Monday or Tuesday.

C: I see.

HMjr: Because I am not satisfied with any information that I have received in regard to that gentleman.

C: I see.

HMjr: I mean, I - I just - I just don't believe it.

C: I see.

HMjr: See?

C: Yes

HMjr: Now, do you think if you were away from Paris on Friday and Saturday that that would be a bad time?

C: I honestly do.

HMjr: You do?

C: Because the situation here is getting more serious every day.

HMjr: I see. Well, then, why not let's leave it this way, the other situation could keep until early next week - I mean your trip to Berlin?

C: Yes

HMjr: So you think you'd better stay in Paris over the weekend?

C: My contact there at this time is down near Basel.

HMjr: I - I didn't get that.

C: I say, I understand the doctor -

HMjr: Yes

C: has recently been down spending a holiday -

HMjr: Yes

C: in a little town in the Black Forest -

HMjr: Yes

C: Badenweiler

HMjr: Yes

C: And he returned to Berlin yesterday I think -

HMjr: Yes

C: Just because of this affair.

HMjr: That's right.

C: And now the question is whether he will remain there or go back to Badenweiler.

HMjr: I see.

C: See?

HMjr: I see.

C: I can find out --

HMjr: Supposing you find out?

C: - by telephone - to Basel and I can find out from there.

HMjr: Yes, I am very anxious for you to have a face-to-face talk with him.

C: Yes

HMjr: See?

C: Yes

HMjr: And - report back. But you think you'd better stay in Paris the next couple of days?

C: Honestly, I do.

HMjr: That's all right.

C: I've had a talk with your friend, you know?

HMjr: With who? - with who?

C: Mr. "C"

HMjr: Yes, I understand.

C: The one we did business with last Spring.

HMjr: I understand.

C: And I sent you one message on him this morning -

HMjr: Yes

C: - where he thinks that it is more to the left than most people anticipate.

HMjr: What is that?

C: He thinks the swing that's here -

HMjr: Yes

C: - is more to the left than most people anticipate.

HMjr: I see.

C: And I've had an interesting talk at the Ministry of Finance today.

HMjr: Yes

C: And I'm sending you a wire on that - it's being coded now.

HMjr: Yes

C: I mean it's been pretty serious.

HMjr: It is?

C: Yes - I mean, they may be just crowding the situation too much but I don't believe they are. They're selling stocks very heavily - shares are dropping - they're holding their funds in cash.

HMjr: They're holding their funds intact?

C: In cash -

HMjr: In cash?

C: See?

HMjr: I see.

C: And so if there should be some bad news Monday as some of these people anticipate -

HMjr: Yes

C: - there may be very heavy pressure and then a nervousness develop in the mass of people here which hasn't existed to date.

HMjr: I see.

C: If that should happen there is a tiny possibility that Sarraut might resign and Reynaud be called in to form a devaluation of the Cabinet.

HMjr: Reynaud?

C: Yes

HMjr: Reynaud?

C: Yes - I think that's our interpretation.

HMjr: Yes, now -

C: I'm sending you that this afternoon, I'm not sure at all but that's a very strong possibility.

HMjr: Well, then -

C:

HMjr: I wish, - hello?

C: Yes

HMjr: I wish that you'd check up again with those New York houses the way you did here a couple of days ago -

C: Fine, I'll do it yet this afternoon.

HMjr: I wish you'd do it again - I wish you'd do it today and Friday.

C: That's tomorrow again, too?

HMjr: Yes - because that was very helpful.

C: Yes - did I give you all you need on Poland?

HMjr: Yes, I'm not particularly interested but that's all right.

C: Well, I mean, that isn't a particularly serious situation.

HMjr: It is?

C: It is not.

HMjr: No

C: No, no - but this is purely domestic with some concern because Austria and Germany and so on -

HMjr: Yes

C: The gold bloc factor isn't having any weight here.

HMjr: Yes - now, I'll call you on the phone again about this time tomorrow morning.

C: Fine

HMjr: I'll call you again about this time tomorrow morning.

C: All right, then -

HMjr: Well, you stay right there.

C: Yes, I'm always back here at two-thirty, you see?

HMjr: What's that?

C: I'm always back here at two-thirty.

HMjr: Well, now, what time have you got there now?

C: It's now three-twenty.

HMjr: Three-twenty?

C: Yes

HMjr: Well, we've got - my time is nine twenty-five, -  
nine-twenty.

C: Yes

HMjr: It's three-twenty in Paris, six hours difference.

C: Six hours difference?

HMjr: Yes, we're on Standard time.

C: Yes

HMjr: Well then, you're always back there by two-thirty which  
is eight-thirty?

C: Usually it's all afternoon.

HMjr: All right

C: Then we can plan the Berlin trip whenever you think  
best - but not before Sunday now.

HMjr: No - all right.

C: All right, then.

HMjr: Goodbye

C: Goodbye.

April 30th - 5:30

Taylor brought to my attention at 5 o'clock that he learned from Mr. Sayre that the State Department would sign the French treaty on Saturday at 1 o'clock - the excuse for this great hurry being that the authority of the present French government expires with the election which comes on Sunday. Taylor informs me that up to this week there has been no apparent rush on the part of the French to sign the treaty but it is perfectly apparent that they are trying to rush this thing through in order to use it as a campaign election argument on Sunday. Taylor felt that it is a great mistake to sign a treaty with a government that is pretty apt to fall on the following day.

My reaction was arrived at from a different direction because I would just as leave see this present French government fall in order that a new government should come in and devalue and get it over with and behind us.

I called the President and he was quite shocked and surprised as he knew absolutely nothing about it. I said to him, "you waited to sign a treaty with Canada until the new government came in. How would it look if you signed a treaty with the French government and the next day it fell". I said, "furthermore, I would just as leave see this government fall as I can handle the French devaluation from an American viewpoint much better now than I could next fall". He got very excited and he said, "it is the craziest thing I ever heard of and", he said, "I would not sign it, I would not think of signing it. I will take care of it immediately". He said, "thank you very much. Good night sir".

April 30, 1936.

MEMORANDUM

TO: Mrs. Klotz

FROM: Mr. Gaston

The Secretary should have the following in his envelope:

- + > 1 - Reading copy of speech
- + > 2 - Question and answer on refunds (1 page)
- + 3 - Income tax estimates and collections,  
1931-1936 (1 page)
- + ✓ 4 - Vote on bonus. (2 pages)
- + > 5 - President's Budget Message, 1937 (white book)
- + > 6 - President's tax message, March 3, 1936. (mimeo.)

April 30, 1936

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THE PRESIDENT'S MESSAGE OF MARCH 3, 1936  
PROPOSING ADDITIONAL TAXES

TO THE CONGRESS OF THE UNITED STATES:

On January third, 1936, in my annual budget message to the Congress, I pointed out that without the item for relief the budget was in balance. Since that time an important item of revenue has been eliminated through a decision of the Supreme Court, and an additional annual charge has been placed on the Treasury through the enactment of the Adjusted Compensation Payment Act.

I said in my budget message:

"\* \* \* the many legislative Acts creating the machinery for recovery were all predicated on two interdependent beliefs. First, the measures would immediately cause a great increase in the annual expenditures of the Government - many of these expenditures, however, in the form of loans which would ultimately return to the Treasury. Second, as a result of the simultaneous attack on the many fronts I have indicated, the receipts of the Government would rise definitely and sharply during the following few years, while greatly increased expenditure for the purposes stated, coupled with rising values and the stopping of losses would, over a period of years, diminish the need for work relief and thereby reduce Federal expenditures. The increase in revenues would ultimately meet and pass the declining cost of relief.

"This policy adopted in the spring of 1933 has been confirmed in actual practice by the Treasury figures of 1934, of 1935, and by the estimates for the fiscal years of 1936 and 1937.

"There is today no doubt of the fundamental soundness of the policy of 1933. If we proceed along the path we have followed and with the results attained up to the present time we shall continue our successful progress during the coming years."

If we are to maintain this clearcut and sound policy, it is incumbent upon us to make good to the Federal Treasury both the loss of revenue caused by the Supreme Court decision and the increase in expenses caused by the Adjusted Compensation Payment Act. I emphasize that adherence to consistent policy calls for such action:

To be specific: The Supreme Court decision adversely affected the budget in an amount of one billion and seventeen million dollars during the fiscal year 1936 and the fiscal year 1937. This figure is arrived at as follows:

Deficit to date (expenditures charge- able to processing taxes less process- ing taxes collected) in excess of that contemplated in the 1937 budget ...	\$ 281,000,000
Estimated expenditures to be made from supplemental appropriation approved in the Supplemental Appropriation Act, 1936 .....	296,000,000
Estimated expenditures to be made under the Soil Conservation and Domestic Allotment Act .....	440,000,000
<hr/>	
Total additional deficit 1936 and 1937, due to Supreme Court decision and adjusted farm program .....	\$1,017,000,000

For the purposes of clarity, I divide the present total additional revenue needs of the Government into the permanent and the temporary ones.

Permanent Treasury income of five hundred million dollars is required to offset expenditures which will be made annually as a result of the Soil Conservation and Domestic Allotment Act recently enacted by the Congress and approved by me; and an additional sum recurring annually for nine years will be required to amortize the total cost of the Adjusted Compensation Payment Act.

The net effect of paying the Veterans' Bonus in 1936, instead of 1945, is to add an annual charge of one hundred and twenty million dollars a year to the one hundred and sixty million dollars already in the budget.

We are called upon, therefore, to raise by some form of permanent taxation an annual amount of six hundred and twenty million dollars. It may be said, truthfully and correctly, that five hundred million dollars of this amount represents substitute taxes in place of the old processing taxes, and that only one hundred and twenty million dollars represents new taxes not hitherto levied.

I leave, of course, to the discretion of the Congress the formulation of the appropriate taxes for the needed permanent revenue. I invite your attention, however, to a form of tax which would accomplish an important tax reform, remove two major inequalities in our tax system, and stop "leaks" in present surtaxes.

Extended study of methods of improving present taxes on income from business warrants the consideration of changes to provide a fairer distribution of the tax load among all the beneficial owners of business profits whether derived from unincorporated enterprises or from incorporated businesses and whether distributed to the real owners as earned or withheld from them. The existing difference between corporate taxes and those imposed on owners of unincorporated businesses renders incorporation of small businesses difficult or impossible.

The accumulation of surplus in corporations controlled by taxpayers with large incomes is encouraged by the present freedom of undistributed corporate income from surtaxes. Since stockholders are the beneficial owners of both distributed and undistributed corporate income, the aim, as a matter of fundamental equity, should be to seek equality of tax burden on all corporate income whether distributed or withheld from the beneficial owners. As the law now stands our corporate taxes dip too deeply into the shares of corporate earnings going to stockholders who need the disbursement of dividends; while the shares of stockholders who can afford to leave earnings undistributed escapes current surtaxes altogether.

This method of evading existing surtaxes constitutes a problem as old as the income tax law itself. Repeated attempts by the Congress to prevent this form of evasion have not been successful. The evil has been a growing one. It has now reached disturbing proportions from the standpoint of the inequality it represents and of its serious effect on the Federal revenue. Thus the Treasury estimates that, during the calendar year 1936, over four and one-half billion dollars of corporate income will be withheld from stockholders. If this undistributed income were distributed, it would be added to the income of stockholders and there taxed as is other personal income. But, as matters now stand, it will be withheld from stockholders by those in control of these corporations. In one year alone, the Government will be deprived of revenues amounting to over one billion three hundred million dollars.

A proper tax on corporate income (including dividends from other corporations), which is not distributed as earned, would correct the serious two-fold inequality in our taxes on business profits if accompanied by a repeal of the present corporate income tax, the capital stock tax, the related excess profits tax and the present exemption of dividends from the normal tax on individual incomes. The rate on undistributed corporate income should be graduated and so fixed as to yield approximately the same revenue as would be yielded if corporate profits were distributed and taxed in the hands of stockholders.

Such a revision of our corporate taxes would effect great simplification in tax procedure, in corporate accounting, and in the understanding of the whole subject by the citizens of the nation. It would constitute distinct progress in tax reform.

The Treasury Department will be glad to submit its estimates to the Congress showing that this simplification and removal of inequalities can, without unfairness, be put into practice so as to yield the full amount of six hundred and twenty million dollars - the amount I have indicated above as being necessary.

-4-

Turning to the temporary revenue needs of the Government, there is the item of five hundred and seventeen million dollars, which affects principally the current fiscal year. This amount must in some way be restored to the Treasury, even though the process of restoration might be spread over two years or three years.

In this case also the formulation of taxes lies wholly in the discretion of the Congress. I venture, however, to call your attention to two suggestions.

The first relates to the taxation of what may well be termed a windfall received by certain taxpayers who shifted to others the burden of processing taxes which were impounded and returned to them or which otherwise have remained unpaid. In unequal position is that vast number of other taxpayers who did not resort to such court action and have paid their taxes to the Government. By far the greater part of the processing taxes was in the main either passed on to consumers or taken out of the price paid producers. The Congress recognized this fact last August and provided in Section 21 (d) of the Agricultural Adjustment Act that, in the event of the invalidation of the processing taxes, only those processors who had borne the burden of these taxes should be permitted to receive refunds. The return of the impounded funds and failure to pay taxes that were passed on result in unjust enrichment, contrary to the spirit of that enactment. A tax on the beneficiaries unfairly enriched by the return or nonpayment of this Federal excise would take a major part of this windfall income for the benefit of the public. Much of this revenue would accrue to the Treasury during the fiscal years 1936 and 1937.

The other suggestion relates to a temporary tax to yield the portion of five hundred and seventeen million dollars not covered by the windfall tax. Such a tax could be spread over two years or three years. An excise on the processing of certain agricultural products is worth considering. By increasing the number of commodities so taxed, by greatly lowering the rates of the old processing tax and by spreading the tax over two or three years, only a relatively light burden would be imposed on the producers, consumers or processors.

FRANKLIN D. ROOSEVELT

The White House,

March 3, 1936.

April 30, 1936

Comparison of actual and estimated income tax receipts, fiscal years 1931-1936, inclusive, daily Treasury statement basis

(in millions of dollars)

July 1 - June 30

Year	Estimated	Actual	Percentage increase (+) or decrease (-) actual over estimated
1931	2,180	1,860	-15.1
1932	1,140	1,057	- 7.3
1933	860	746	-13.3
1934	864	818	- 5.3
1935	1,051	1,099	+ 4.6
1936	1,434	-	-

July 1 - April 27

1936	1,063	1,078	+ 1.4
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Treasury Department,  
Division of Research and Statistics

April 29, 1936

SENATORS WHO VOTED FOR BONUS BILL AND TO OVERRIDE  
PRESIDENT'S VETO

Adams	Carey	Hatch	Norbeck	Thomas (Utah)
Ashurst	Chavez	Holt	Norris	Trammell
Austin	Clark	La Follette	Nye	Truman
Bachman	Coolidge	Lewis	O'Mahoney	Van Nuys
Bailey	Copeland	Logan	overton	Walsh
Bankhead	Costigan	Loneragan	Pitman	White
Barbour	Davis	McAdoo	Pope	
Barkley	Dickinson	McCarran	Radcliffe	
Benson	Dieterich	McGill	Reynolds	
Bilbo	Donsahy	McKellar	Robinson	
Black	Duffy	McNary	Russell	
Bone	Frazier	Maloney	Schwellenbach	
Borah	George	Minton	Sheppard	
Bulow	Gibson	Moore	Shipstead	
Byrnes	Gore	Murphy	Smith	
Capper	Guffey	Murray	Stiewer	
Caraway	Harrison	Neely	Thomas (Okla.)	

SENATORS WHO ARE LISTED AS "NOT VOTING" ON  
PASSAGE OF BILL, WHO BUT VOTED TO OVERRIDE PRESIDENT'S VETO

Metcalf  
Wheelr.

SENATORS WHO VOTED AGAINST BONUS BILL AND  
AGAINST OVERRIDING VETO

Brown	Couzens	Hastings	King
Bulkley	Gerry	Hayden	Townsend
Burke	Glass	Johnson	Vandenberg
Byrd	Hale	Keyes	Wagner

SENATORS WHO WERE LISTED AS "NOT VOTING" ON  
PASSAGE OF BILL AND WHO VOTED AGAINST OVERRIDING VETO

Connally  
Fletcher  
Tydings

SENATORS WHO VOTED FOR BONUS BILL AND TO  
OVERRIDE PRESIDENT'S VETO

Bailey  
Barkley  
Black  
Capper  
Clark  
George  
Gore  
Guffey  
Harrison  
LaFollette  
Lonergan  
Walsh  
Costigan

SENATORS WHO WERE LISTED AS "NOT VOTING"  
ON PASSAGE OF BILL, BUT WHO VOTED TO OVER-  
RIDE PRESIDENT'S VETO

Metcalf

SENATORS WHO VOTED AGAINST BONUS BILL AND  
AGAINST OVERRIDING VETO

Byrd  
Couzens  
Gerry  
Hastings  
Keyes  
King

SENATORS WHO WERE LISTED AS "NOT VOTING"  
ON PASSAGE OF BILL AND WHO VOTED AGAINST  
OVERRIDING VETO

Connally

Statement of Secretary Morgenthau before the  
Senate Finance Committee, Thursday, April 30, 1936.

I welcome the opportunity to appear and discuss with you the tax proposals contained in the President's message to the Congress of March 3rd, and to present the Treasury's viewpoint.

As Secretary of the Treasury, I feel a special responsibility to do all in my power to maintain the integrity of the President's Budget of January 3, 1936; and therefore to urge that the supplemental revenues made necessary by the developments of the past few months be provided.

The Treasury has been able to borrow readily the amounts necessary to finance the recovery program and has been able to obtain these loans at steadily decreasing interest rates. The continuance of this satisfactory situation, however, will depend upon scrupulous adherence to an orderly program looking to a balance of the Federal budget just as soon as the needs and abilities of our people make that possible and thereafter upon a steady reduction in the public debt.

In his Budget Message of January 3, 1936, the President made this statement: "If the Congress enacts legislation at the coming session which will impose additional charges upon the Treasury, for which provision is not already made in this Budget, I strongly urge that additional taxes be provided to cover such charges. It is important as we emerge from the depression that no new activities be added to the Government unless provision is made for additional revenue to meet their cost."

At another point in the same message the President said: "It is pertinent to repeat here a statement appearing in the Summation of the 1936 Budget: 'Estimates of receipts contemplate continued collection

tax, described as a "windfall" tax, on the unjust enrichment accruing to some corporations and individuals as a result of their escape from the payment of processing taxes. The amount of the processing taxes due prior to January 6th which had thus escaped was approximately \$237,000,000.

The third suggestion, and the one of major importance, was for a revision of our system of corporation taxes. It was proposed by the President that the three existing forms of corporate taxes be repealed. These include the capital stock tax, the excess profits tax, and the corporation income tax. The President proposed that there be substituted for these taxes a tax upon that portion of corporation income which is not currently distributed to stockholders in dividends and that at the same time the present exemption from the normal income tax of four per cent of dividends received by individuals from corporations be repealed.

The status of the President's proposals today is that the House has passed a bill to give effect to two of them. The House bill is estimated by the Treasury to yield additional revenue as follows: (a) Net continuing revenue of \$623,000,000 yearly from a tax on corporate earnings, and (b) net temporary revenue of \$180,000,000 from an unjust enrichment tax and temporary extension of the capital stock tax, divided as follows: From the unjust enrichment tax, \$100,000,000; from the extension of the capital stock tax for one year at one-half of the present rate, \$80,000,000.

The bill thus fully provides the \$620,000,000 needed to take care of the permanent agricultural program and the annual financing of the payment of the soldiers' bonus. It also provides for the first year of a three year program for recouping the loss of \$517,000,000 of processing taxes lost during the fiscal year 1936. However, it does not provide any temporary revenues for the two succeeding years to make up the balance of \$337,000,000 of temporary revenues desired.

The estimated yield of \$623,000,000 from the tax on corporate earnings is the amount of additional revenue to be derived from the application of the rates and schedules in the House bill to corporate income for the present calendar year, 1936. It must be recognized that the choice of an income tax as the means for raising additional revenue necessarily involves a delay in realization of increased receipts. Receipts from taxes on corporate incomes for the calendar year 1936 will be collected in the main during the calendar year 1937 and will be divided between the two fiscal years, the fiscal year 1937, ending June 30, 1937, and the fiscal year 1938. The net additional revenue to be expected from the application of the corporate income tax is estimated to be \$310,000,000 in the fiscal year 1937. The full additional annual revenue would be collected in the fiscal year 1938.

The House bill follows the President's suggestions in providing for the repeal of the corporation income tax, the capital stock tax and the excess profits tax and by making dividends received by individuals subject to the normal tax of four per cent. In place of the repealed taxes it substitutes a new form of tax on corporate income with rates

based on the percentage retained by the corporation. The estimated annual yield of \$623,000,000 is the amount by which it is expected taxes paid by corporations and individuals under the proposed plan will exceed the yield of corporate and individual taxes under the present law.

It is to be noted that the bill as passed by the House of Representatives, while failing, according to our estimates, to raise temporary revenues for a three-year period in the full amount sought by the President, utilizes but two of his three suggestions. The third was for the enactment of processing taxes on a broader base but with lower rates than were in effect under the Agricultural Adjustment Act. I call this potential source of additional revenue to your attention again. I feel sure that the Department of Agriculture stands ready to supply any information you may desire on this subject.

Turning from the revenue aspects of the House bill, in which the Treasury is primarily interested, let us consider also the two suggestions made by the President, to which the House bill gives effect, from the standpoint of equity in our tax system.

As to the proposed unjust enrichment tax, I think there is little that need be said. I have not heard the justice of this tax very seriously questioned. There is no doubt whatever that the avoidance of payment of processing taxes accrued prior to January 8th has resulted in unjust gains to a limited number of persons and corporations. It would be grossly unfair to the persons and corporations who paid their processing taxes as due up to the time of the Supreme Court's decision and it would be unfair to the American consumer, who ultimately bore the major burden of the taxes, not to reduce this unjust enrichment as much as we can by taxation.

I take it for granted that an unjust enrichment or "windfall" tax will be enacted by the Congress. I assume, too, that you will give most serious consideration to the matter of the deficiency in the temporary revenue for a three-year period expected from the House bill as compared with the President's estimates of the need. I turn, therefore, to the proposed tax on corporate income.

The principle of taxation according to ability to pay is now well established, not merely by having been written by amendment into the Constitution of the United States and supported by twenty years of application in our tax structure, but by the undoubted and unquestioned endorsement and support of the citizens of this Nation. Through successive changes in our tax laws, however, we have departed most seriously from a consistent and just application of the principle. Under the existing law we apply the principle to individual incomes, whether they are obtained from interest, rents, or salaries, from the profits of individual business enterprise or from partnership undertakings. We do not apply it to profits gained from corporate enterprise, except in a manner which taxes some citizens at unfairly high rates and gives to others the opportunity to avoid taxation on a wholesale scale.

Where a corporation makes approximately full distribution of its current earnings, the stockholder under present law first bears the burden of three different corporation taxes -- the capital stock tax, the excess profits tax and the corporate income tax; second, he is required to pay surtaxes on the dividends paid to him. This stockholder thus pays what is in effect a normal tax of about 15 to 16 per cent as compared to a normal tax of four per cent paid by the individual

who derives his income from other sources. On the other hand, the present law permits stockholders of large incomes to avoid the payment of surtaxes which may run to rates as high as 75 per cent on their share of corporate earnings which are not distributed as dividends.

What are the dimensions of tax avoidance with which we are dealing? A few simple figures tell the story. It has been estimated by the Treasury Department that under the present tax law the income tax liability of corporations on the basis of 1936 earnings would approximate 964 millions. The Department has also estimated that under the present law more than four and one-half billion dollars of corporation income in the calendar year 1936 will be withheld from stockholders and that if this income were fully distributed to the individual owners of the stock represented in these corporations, the resultant yield in additional individual income taxes would be about one billion three hundred millions.

With tax avoidance occurring on the scale indicated by the figures I have cited, I do not see how any increase in individual income tax rates or other general and continuing taxation could be justified until this leak in our tax system is stopped.

Whatever may be the debatable considerations that may enter into the preparation of particular schedules, it will be well to bear in mind at all times that this is purely and simply a proposal to put all taxes on business profits essentially on the same equitable basis; to give no advantages and to impose no penalties upon corporation stockholders that are not given to and imposed upon the individual taxpayer who alone or as a partner derives his income from business profits.

In closing let me say this. I sincerely hope that this Committee will report to the Senate a bill giving effect, as fully as possible, to the President's recommendations of the amount of additional revenue needed to supply the deficiencies created since the Budget Message of January 3rd.

--oOo--

April 30, 1936 204

**CONFIDENTIAL!**

To be held in STRICT CONFIDENCE and no portion, synopsis, or intimation to be published or given out until the READING of the President's Budget Message has been begun in the Senate or House of Representatives. While the Message and the Budget of the United States are dated JANUARY 3, 1936, some contingency may arise to prevent its delivery to the Houses of Congress on that date, and extreme care must therefore be exercised to avoid premature publication.

CAUTION: This Budget Message must not be confused with the President's Annual Message. A separate release is necessary.

STEPHEN EARLY,  
*Assistant Secretary to the President.*

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**THE PRESIDENT'S  
BUDGET MESSAGE FOR 1937  
AND  
SUMMARY BUDGET STATEMENTS**

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U. S. GOVERNMENT PRINTING OFFICE : 1936

## BUDGET MESSAGE OF THE PRESIDENT

*To the Congress of the United States:*

Pursuant to provisions of law I transmit herewith the Budget of the United States Government for the fiscal year ending June 30, 1937, together with this message, which is definitely a part thereof. The estimates have been developed after careful analysis of the revenues, obligations, and reasonable needs of the Government, and I recommend appropriations for the purposes specifically detailed in the tables which follow.

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### PART I

No mortal is permitted unflinchingly to predict the future. This is particularly true of estimates which relate to the money values of property and services in a world of nations torn by dissension, by violent price fluctuations, and by forebodings of the future.

It is, therefore, a cause for congratulation within our own Nation to realize that a consistent, broad national policy, adopted nearly three years ago by the Congress and the President, has thus far moved steadily, effectively, and successfully toward its objective.

In March 1933 in spite of substantial increases in tax rates during the preceding administration, Federal tax receipts had fallen to such a low level that even normal expenses of Government could not be carried on without creating a mounting deficit. In addition to normal expenses the problem of millions of starving unemployed called for a relief program which obviously would greatly increase that deficit.

The national policy which we then adopted sought to stop the downward economic spiral by taking simultaneous action along a dozen fronts. The chief objectives were: To make bank deposits secure, to save farms and homes from foreclosure, to start public works on a large scale, to encourage home building, to increase farm crop values, to give useful work instead of a dole to the needy unemployed, to reduce all interest rates, to increase foreign trade in both exports and imports, to extend Government credit to railroads and other privately owned activities, to reduce unsound and generally disastrous speculation, to eliminate starvation wages, to seek a higher level of values, and then to maintain those values.

On the part of the Federal Government the many legislative acts creating the machinery for recovery were all predicated on two inter-

dependent beliefs. First, the measure would immediately cause a great increase in the annual expenditures of the Government—many of these expenditures, however, in the form of loans which would ultimately return to the Treasury. Second, as a result of the simultaneous attack on the many fronts I have indicated, the receipts of the Government would rise definitely and sharply during the following few years, while greatly increased expenditure for the purposes stated, coupled with rising values and the stopping of losses would, over a period of years, diminish the need for work relief and thereby reduce Federal expenditures. The increase in revenues would ultimately meet and pass the declining cost of relief.

This policy adopted in the spring of 1933 has been confirmed in actual practice by the Treasury figures of 1934, of 1935, and by the estimates for the fiscal years of 1936 and 1937.

There is today no doubt of the fundamental soundness of the policy of 1933. If we proceed along the path we have followed and with the results attained up to the present time we shall continue our successful progress during the coming years.

Stated even more concisely, we can look forward today to a continued reduction of deficits, to increased tax receipts, and to declining expenditures for the needy unemployed. Let it be remembered that the major part of the increase in tax receipts anticipated in 1937 over 1936 from comparable sources is coming from old tax schedules. The only changes made last year in the tax schedule were, first, the elimination of the tax on checks and, secondly, slight increases in taxes on large incomes, on large estates, and on large corporations and in capital stock and excess profits taxes. By the elimination of the tax on checks we lost forty million dollars in revenue and the slight increases on estates and on personal and corporate incomes will add only about 222 million dollars to Government receipts this coming year. I emphasize that the great bulk of increased Government income referred to above results from increased earning power and profits throughout the Nation and not from the new taxes imposed by the Revenue Act of 1935.

Final success will depend, of course, on the strength of the efforts put forth by the employers of the United States greatly to increase the number of persons employed by them. The finances of the Government are in better condition than at any time in the past seven years. I say this because starting with the autumn of 1929 tax receipts began a steady and alarming decline while, at the same time, Government expenditures began a steady rise; today, tax receipts are continuing a steady climb which commenced in the summer of 1933, whereas Budget estimates for the next fiscal year will show a decreased need for appropriations.

The credit of the Government is at its highest. The average of the business men of the Nation stand ready to do their share. It is to be hoped that motives and attacks which spring only from the desire for political or financial power on the part of a few will not retard the steady progress we are making.

Our policy is succeeding. The figures prove it. Secure in the knowledge that steadily decreasing deficits will turn in time into steadily increasing surpluses, and that it is the deficit of today which is making possible the surplus of tomorrow, let us pursue the course that we have mapped.

In my Budget message of January 1935 I said, "I am, however, submitting to the Congress a Budget for the fiscal year 1936 which balances except for expenditures to give work to the unemployed. If this Budget receives approval of the Congress, the country will henceforth have the assurance that with the single exception of this item, every current expenditure of whatever nature will be fully covered by our estimates of current receipts. Such deficit as occurs will be due solely to this cause, and it may be expected to decline as rapidly as private industry is able to reemploy those who now are without work."

In looking at the revised estimates for the fiscal year 1936 I am more than pleased to find that we have not only accomplished what I said we would in my Budget message of a year ago but that the results with respect to both expenditures and receipts have surpassed expectations.

1. My Budget message of January 1935 forecast that the expenditures for the fiscal year 1936 would be \$5,520,000,000. Our most recent estimate shows that our expenditures will be \$7,045,000,000, or \$875,000,000 less than originally forecast.

2. Receipts were estimated in January 1935 at \$1,992,000,000. At the present time it appears that they will be \$4,811,000,000, or an increase of \$419,000,000.

3. The message of January 1935 forecast a gross deficit of \$4,528,000,000, and the most recent figures show that the deficit will be \$3,224,000,000, or a decrease of \$1,294,000,000.

This great improvement of the fiscal outlook during this present year has been brought about through policies which the Congress and the President initiated in 1933 and which we have since maintained.

Now let us look at the Budget for the fiscal year 1937:

To run all the regular activities of the Government I will need a total of \$5,000,000,000. These regular activities include interest on the public debt, major public works, operations of the Civilian

Conservation Corps, and agricultural benefit payments, but do not include strictly work relief items. I expect to pay for those regular activities with estimated receipts of \$5,654,000,000, leaving an excess of receipts of \$385,000,000. Out of this \$385,000,000 I will need \$380,000,000 for debt retirement, which will still leave \$5,000,000 of excess receipts over expenditures after having paid for all of the regular expenditures of the Government plus debt retirement.

The item for relief remains. Without that item the Budget is in balance. To make today a formal Budget estimate of the amount necessary for work relief would be of necessity a difficult task. We have too recently reached our goal of putting three and one-half million people at work; and the beneficial effects from this program and from increasing expenditures on public works cannot be foretold as accurately today as it can two months from now. Furthermore, employment by private industry continues to show substantial gains over the figures of a year ago. It is reasonably certain that the total appropriations for work relief during the fiscal year 1937 will be far less than during the current fiscal year. It is estimated in this Budget that expenditures for recovery and relief out of unexpended balances of previous emergency appropriations will amount to \$1,103,000,000. Including these expenditures the gross deficit for 1937, without an estimate for additional work relief, is less than the gross deficit for 1936 by \$2,136,000,000. I do not anticipate that the need for additional relief funds will be as great as that sum.

To state the case even more precisely, the gross deficit of the Government in 1934 was \$5,280,000,000; in 1935, \$3,575,000,000; in 1936 (estimate), \$3,334,000,000; and in 1937 (estimated but not including any new appropriations for work relief), \$1,998,000,000. Therefore, it is clear: First, that since June 30, 1934, the gross deficit of the Government shows a steady decrease during the fiscal years 1935 and 1936. Second, that if work relief appropriations by this session of the Congress were made up to a total of \$2,136,000,000, the total gross deficit for the fiscal year 1937 would not exceed that of 1936, which was the lowest gross deficit of the past three years. Therefore, it follows that by whatever amount the appropriation for work relief at this session is less than \$2,136,000,000, the gross deficit for 1937 will be less than the deficit for 1936 by the same amount.

With this limitation and this excellent prospect clearly in mind, I am not including in this Budget estimates for additional relief appropriations. I shall transmit such estimates with far greater knowledge and, therefore, with greater accuracy in sufficient time before the adjournment of this session to give the Congress full opportunity to examine into the subject and to make the necessary appropriations.

The credit of the Government is in sound condition: On October 15, 1935, war-time issues of First and Fourth Liberty bonds were outstanding in the aggregate amount of \$8,300,000,000, bearing interest at an average rate of about 4¼ percent. Today this entire amount has been refunded, of which about \$5,000,000,000 was exchanged for long-term bonds bearing interest at rates ranging from 2¾ to 3¼ percent per annum; \$1,900,000,000 was exchanged for Treasury notes bearing interest from 1½ to 2¼ percent per annum, and the balance was paid in cash. The average rate on the securities issued to refund the Liberty bonds is less than 2¾ percent per annum, a saving of approximately 1½ percent a year, or an annual reduction in interest payments of more than \$100,000,000 on these particular securities.

The average rate on the interest-bearing debt was on June 30, 1934, approximately 3.18 percent, whereas on November 30, 1935, it had been reduced to 2.575 percent.

If the Congress enacts legislation at the coming session which will impose additional charges upon the Treasury for which provision is not already made in this Budget, I strongly urge that additional taxes be provided to cover such charges. It is important as we emerge from the depression that no new activities be added to the Government unless provision is made for additional revenues to meet their cost.

## PART II

### RECOMMENDATIONS

The following recommendations are offered:

*Appropriation transfer provisions.*—The text accompanying a number of the estimates of appropriations has been drafted to include provision for transfer between appropriations within the same department. This provision will add a measure of administrative flexibility and will tend to promote economical execution of the program as a whole, and approval thereof by the Congress is recommended.

*Repeal amendment to Agricultural Adjustment Act.*—During the first session of the Seventy-fourth Congress the Agricultural Adjustment Act was amended so as to appropriate a sum equal to 80 percent of customs receipts to the Secretary of Agriculture to encourage exportation and domestic consumption of agricultural commodities. No estimate of expenditure for account of this legislation is included herein; and repeal of the amendment is recommended for the following reasons:

By appropriating directly instead of authorizing an appropriation the amendment denies to the President the opportunity to con-

sider the need and include appropriate estimates in the Budget; and it denies to the Congress the opportunity to review such estimates in their relation to the whole program of the Government. The amendment violates the principles of the Permanent Appropriation Repeal Act of 1934, and of the Budget and Accounting Act of June 10, 1921. It is in conflict with sound administration in that it provides in advance for large annual expenditures without any attempt to coordinate income and expense. The amendment was passed in the last days of the session as a result of conference agreement and without the debate and consideration by the Congress which the import of the measure clearly justifies.

*Apportionments of appropriations.*—Within the last few months control of the administrative expense of 20 emergency agencies has been vested in the Bureau of the Budget which after a general survey of all of them has effected substantial reductions in proposed expenditures for administrative purposes. Allowances for administrative expenses are subject to such adjustment as the status of the agency warrants.

The 20 agencies brought under the Budget are the Agricultural Adjustment Administration; Commodity Credit Corporation; Electric Home and Farm Authority; Export-Import Banks (2); Farm Credit Administration; Federal Coordinator of Transportation; Federal Deposit Insurance Corporation; Federal Emergency Administration of Public Works; Federal Emergency Relief Administration; Federal Farm Mortgage Corporation; Federal Home Loan Bank Board; Federal Housing Administration; Federal Savings and Loan System; Federal Savings and Loan Insurance Corporation; Federal Surplus Relief Corporation; Home Owners' Loan Corporation; National Recovery Administration; Reconstruction Finance Corporation and Tennessee Valley Authority.

It is recommended that section 9679 of the Revised Statutes be amended so as to bring all agencies of the Government, including Government-owned and Government-controlled corporations, within the authority of the Director of the Budget with respect to apportionments of appropriations and of other funds available to them.

### PART III

#### REVIEW OF FISCAL YEARS 1936 AND 1937 AND THE FISCAL PROGRAM OF 1937

This review concerns itself with cash actually received and paid out by the Treasury in the fiscal year 1936; and with the estimates of receipts, appropriations, and expenditures for the fiscal years 1936

and 1937. As elsewhere stated herein the program of regular activities for 1937 includes activities under the Agricultural Adjustment Act and the Civilian Conservation Corps (Emergency Conservation Work), heretofore classed as emergency. Therefore the figures used herein for 1934, 1935, and 1936 have been adjusted to a comparable basis.

#### FISCAL YEAR 1936

*Receipts.*—Treasury receipts for the year ended June 30, 1936, were in excess of estimates prepared a year ago. Considering all sources except postal revenues, total receipts amounted to \$3,900,467,202, or \$89,000,000 above the estimate. Internal revenues, including processing taxes on farm products, produced \$1,277,090,026, exceeding the estimate by \$80,000,000. Customs receipts amounted to \$343,353,033, an increase over the estimate of \$66,000,000. Miscellaneous receipts, including realization upon assets, estimated at \$927,184,181, fell short of the estimate by \$48,000,000; the amount actually received under this item was \$179,424,140.

*Expenditures.*—While actual receipts for the year were greater than anticipated, actual expenditures were less than the amount estimated by \$1,205,000,000. The aggregate of all expenditures was \$7,375,925,166, against an estimate of \$8,581,000,000. Approximately a billion dollars of this difference related to recovery and relief, and the regular agencies accounted for the remainder.

The total spent for recovery and relief was \$3,068,803,023, whereas the 1936 Budget estimate was \$4,028,541,852, exclusive of expenditures made under the Agricultural Adjustment Act and made by the Civilian Conservation Corps. This difference is partly due to this fact:

When the Budget for 1936 was prepared it seemed probable that the Reconstruction Finance Corporation, in all accounts except relief, would close the year with an excess of loans over repayments; and the amount of the net expenditures was estimated at \$550,000,000. However, because of improved business conditions, the demands for Corporation assistance were so much less than estimated and the repayments of loans so much greater, that the Corporation actually closed the year with net receipts of \$107,000,000. Therefore, the net difference between the estimated expenditure and the actual result amounted to \$657,000,000. Other agencies spent for recovery and relief \$537,000,000 less than estimated.

For the operation and maintenance of regular departments and establishments of the Government, including the Agricultural Adjustment Act and the Civilian Conservation Corps, actual expenditures were \$2,912,537,509, against the estimate of \$3,104,951,174.

For statutory debt retirements there was expended \$573,568,250, and for interest on the public debt \$330,226,353, whereas the amounts budgeted for these items were, respectively, \$572,566,000 and \$330,000,000.

*Deficit and public debt.*—The year closed with a gross deficit of \$3,575,357,964 instead of the estimate of \$4,869,415,338. After deducting the amount paid out for statutory debt retirement the net deficit was \$3,001,799,714. The increase in the total outstanding gross public debt was \$1,647,751,210, which figure is properly obtained by subtracting from the net deficit the decrease in the general fund balance, the excess of receipts from trust funds, increment on gold, et cetera, over expenditures from the same accounts, and the amount of retirement of national-bank notes from the gold increment. As of June 30, 1935, the total outstanding gross public debt was \$28,700,592,624, while on June 30, 1934, it was \$27,053,141,414.

#### FISCAL YEAR 1936

Drawing upon the experience of the first six months of the current year it is possible to forecast with a fair degree of accuracy the results of financial operations for the whole 1936 fiscal period.

*Receipts.*—The same sources of income (excluding postal revenues) which a year ago were expected to produce receipts aggregating \$3,991,904,839 are now expected to produce a total of \$4,410,793,948.

Of the items comprising the whole, income taxes will develop \$1,484,112,000, or \$246,000,000 more than the 1936 Budget estimate.

Miscellaneous internal revenue exclusive of processing taxes is now estimated at \$1,573,091,000, an increase of \$187,000,000. Receipts from customs are expected to reach a total of \$363,191,000, exceeding the original estimate by \$65,000,000. Other changes, some upward and some downward, result in the new estimate of total receipts at a figure of \$419,000,000 higher than shown in the Budget for 1936 which was presented a year ago.

The present estimate for processing taxes in 1936, included in above total, is in round figures \$529,000,000, as against the original estimate of \$570,000,000. Actual receipts for the five months ended November 30, 1935, totaled \$56,000,000, while up to that date approximately \$145,000,000 of due payments had been impounded as the result of preliminary court action.

It is pertinent to repeat here a statement appearing in the Summary of the 1936 Budget: "Estimates of receipts contemplate continued collection of processing taxes. If the attack which has been made upon this act is sustained we will have to face the problem of

financing existing contracts for benefit payments out of some form of new taxes."

Two new taxes, namely, the bituminous coal tax and the taxes upon carriers and their employees, both representing recent legislation, will contribute \$30,000,000 not included in the original estimate of receipts for 1936. New taxes imposed by the Social Security Act and the Revenue Act of 1935 will not produce any income until the fiscal year 1937.

*Expenditures.*—Indications are that expenditures including debt retirement during the present fiscal year will not reach the amount budgeted by approximately \$875,000,000; the total new forecast is \$7,645,301,338, against the original estimate of \$8,520,415,600. Exclusive of debt retirement the total of expenditures is now estimated at \$7,093,276,336, while the original comparable figure was \$7,885,979,800. For recovery and relief the revised estimate of expenditures for the fiscal year 1936 is less than the original Budget estimate by \$738,000,000, and expenditures for all regular purposes, including Agricultural Adjustment Act and Civilian Conservation Corps, will be less by \$137,000,000. Debt retirement will require \$84,000,000 less than was budgeted and interest payments will be \$183,000,000 less. All regular expenditures, excluding service on the public debt, will be greater than the original Budget estimate by about \$80,000,000.

The reduction in interest payments from the amount budgeted, as referred to above, was due largely to the refunding of First and Fourth Liberty Loan bonds aggregating \$3,500,000,000, at substantially lower rates of interest.

*Deficit and public debt.*—The revised estimates as set out herein show a gross deficit for the current fiscal year of approximately \$3,284,000,000, instead of the original Budget forecast of \$4,829,000,000. After deducting the amount of statutory debt retirement the net deficit will be, in round figures, \$2,282,000,000. The gross public debt as at June 30, 1936, should not be greater than \$31,000,000,000. This estimate assumes that the working balance in the Treasury on June 30, 1936, will be approximately the same as it was on June 30, 1935, namely, \$1,001,142,951. Obviously, if the working balance is less, the gross debt will be less; and if it is greater, the gross debt will be greater.

The foregoing figures are set out in the following table for ready comparison between Budget estimates of a year ago and what are now considered probable.

Comparison of original and revised estimates, fiscal year 1937, adjusted to classification of expenditures in 1937 Budget

	Original estimates, January 1937	Revised 1937
<b>C. Receipts (including public):</b>		
Taxation:—		
Excise tax	\$1,188,000,000	\$1,218,110,000
Miscellaneous internal revenue	1,882,000,000	1,873,000,000
Processing taxes on farm products	275,000,000	280,000,000
Customs	208,000,000	202,180,000
All other	200,000,000	221,250,000
Total receipts	3,961,000,000	4,110,760,000
<b>D. Expenditures:</b>		
Members, including A. A. A. and C. C. C.	2,402,551,134	2,405,200,121
Interest on the public debt	473,000,000	513,000,000
Emergency and relief	2,000,000,000	2,000,000,000
Total expenditures	5,880,000,000	7,000,770,000
<b>E. Net deficit:</b>		
Estimated deficit, retirement	2,402,074,070	2,982,000,000
Interest on the public debt	473,000,000	513,000,000
Other deficit	4,278,000,000	4,291,000,000
Grand public debt	\$4,753,074,070	\$4,992,000,000

Postal revenues for the fiscal year 1937 are now estimated at \$670,000,000, which is \$25,000,000 over the original estimate.

#### THE FISCAL PROGRAM OF 1937

There is presented here a brief factual résumé of the principal features of the Budget for the fiscal year 1937, the details of which appear in subsequent text and tables. A few high points stand out and justify emphasis.

Without impairing the ability of the Government to carry on its normal functions and to prosecute those activities essential to continued recovery, the Budget reflects a substantial decrease in the spread between income and outgo. This is consistent with the prediction made in the Budget message a year ago and is possible because of progressive improvement in the economic status of the people. The state of national recovery is such that receipts from prevailing tax sources on the basis of present rates appear adequate for financing the ordinary operations of the Government in 1937, including service on the public debt; and no new or additional taxes are proposed.

Legislation enacted by the first session of the Seventy-fourth Congress makes it necessary to provide in the 1937 estimates new appropriation items aggregating \$667,000,000. This total will become

approximately \$767,000,000 should the Congress reject the recommendation, hereinbefore offered, for repeal of that part of the Agricultural Adjustment Act which appropriates a sum equal to 30 percent of customs receipts to the Secretary of Agriculture.

Legislation enacted by the first session also permits including in these estimates a total of \$700,000,000 of additional receipts, of which about 70 percent will accrue under the Bituminous Coal Conservation Act, the act levying taxes upon carriers and their employees, and the Social Security Act. It is worthy of note that but slightly less than 30 percent of this increase will be derived under the Revenue Act of 1935. This act, it will be recalled, slightly increased taxes on individuals whose net incomes exceed \$50,000 per year; slightly increased estate taxes on larger fortunes with a corresponding increase in gift taxes; and in respect of corporations, decreased taxes on net earnings of small corporations while increasing in relative ratio the taxes on net income of larger corporations. The act also provided for an increase in taxes on capital stock and on excess profits of corporations. The effect of the excess-profits tax was to increase taxes on corporations which earned in excess of certain percentages of their adjusted declared value of capital stock.

The total revenue expected to be produced by these taxes in the fiscal year 1937 will be only \$222,000,000, or 11 percent, over the income, estate, gift, capital-stock, and excess-profits taxes under the old law. Since collections in the fiscal year 1937 from income taxes and the estate tax only partially reflect the Revenue Act of 1935, the above amount will be somewhat larger on a full year basis.

A Federal public-works program of \$405,000,000 is recommended to meet in part the development and improvement requirements of the Government, and as a proper Federal contribution to work opportunity. While this program represents an increase of about \$187,000,000 over the amount for similar purposes for which the Congress made specific appropriations for the current fiscal year, it is \$333,000,000 less than the total amount made available for Federal public works in 1936, considering allotments made from emergency funds.

The success attending the operations of the Civilian Conservation Corps and the Agricultural Adjustment Administration under emergency status justifies taking them into the Budget and program for 1937 as regular activities, and the estimates of appropriations and expenditures have been prepared accordingly. The appropriation recommended for Civilian Conservation Corps is for the period March 31, 1936, to March 31, 1937, and amounts to \$246,000,000, while the appropriation for the Agricultural Adjustment Administration is for the full year and amounts to \$409,054,285.

The following table gives a clear picture of the main figures proposed in this Budget and shows how they compare with similar figures for previous years.

(In millions of dollars)

	Actual		Estimated	
	1934	1935	1936	1937
<b>I. Receipts:</b>				
Income taxes.....	115	1,090	1,024	1,039
Miscellaneous internal revenues.....	1,470	1,867	1,852	2,308
Processing taxes.....	102	121	122	120
Customs.....	213	200	200	204
Miscellaneous.....	302	180	185	190
Taxes under the Social Security Act, the act levying taxes upon carriers and their employees, and the Bituminous Coal Conservation Act.....			20	347
<b>Total receipts.....</b>	<b>3,119</b>	<b>5,460</b>	<b>4,403</b>	<b>5,038</b>
<b>II. Expenditures:</b>				
<b>1. Regular:</b>				
Operation and maintenance of Federal Government and establishments.....	1,000	1,000	1,000	2,255
Veterans' pensions and benefits.....	100	100	700	700
Interest on national debt.....	721	801	923	905
Tax refunds (exclusive of processing taxes).....	43	43	47	40
Agricultural Adjustment Act.....	200	170	182	173
Civilian Conservation Corps.....	232	450	220	220
Statutory debt retirements.....	300	675	660	660
<b>Total regular.....</b>	<b>3,496</b>	<b>4,369</b>	<b>4,722</b>	<b>5,513</b>
Excess of revenues over regular expenditures.....				2
Excess of regular expenditures over receipts.....	28	360	300	
<b>2. Recovery and relief:</b>				
<b>Total.....</b>	<b>3,985</b>	<b>3,388</b>	<b>3,800</b>	<b>4,100</b>
Gross deficit.....	3,985	3,378	3,204	3,900
Gross public debt.....	27,302	26,701	26,523	25,321

\* Represents unexpended expenditures from unexpended balances of previous emergency appropriations.

Directing attention to a comparison between fiscal operations proposed for 1937 and now estimated for 1936, as set forth in the table, the following comment is pertinent:

**Receipts.**—Receipts in 1937 (exclusive of postal revenues and processing taxes and also, for purposes of comparison, exclusive of taxes imposed under the Social Security Act, the Bituminous Coal Conservation Act, and the act levying taxes upon carriers and their employees) are expected to reach a total of \$4,539,817,650, an increase of \$716,665,704 over similar receipts for 1936 now estimated at \$3,848,151,946, and \$1,280,780,319 over 1935. It should be pointed out here that this increase is due largely to increased collections

anticipated under the old schedules. As has been stated, only about \$222,000,000 will be collected in 1937 as a result of new schedules in the Revenue Act of 1935.

From processing taxes the sum anticipated is \$547,300,000, against the estimate of \$529,042,000 for the current year, an increase of \$18,258,000. Other taxes recently authorized by the Congress under the Social Security Act, the Bituminous Coal Conservation Act, and the act levying taxes upon carriers and their employees will produce \$547,100,000 in 1937 and \$38,600,000 this year, an increase of \$508,500,000.

Thus 1937 receipts from all sources, except postal revenues, are estimated at \$5,554,217,830, against the revised estimate of \$4,410,798,946 for the current fiscal year. The increase in total receipts from stated sources is, therefore, \$1,243,428,704.

Postal receipts for the coming year are estimated at \$705,000,000, an increase of \$35,000,000 over \$670,000,000 anticipated in 1936. This is further evidence of the upward trend in economic conditions.

An examination of the detailed estimates of receipts for 1937 indicates a gain over 1936 in income tax of \$508,489,000, the figures for the two years being respectively \$1,942,000,000 and \$1,434,112,000. Similarly, estimated receipts from miscellaneous internal revenue, exclusive of processing taxes, are up from \$1,873,001,000 to \$2,108,114,000, a gain of \$235,023,000. Customs receipts are forecast at \$384,000,000, substantially the same as anticipated for 1936. The reduction of \$22,654,396 in probable miscellaneous receipts, from \$182,757,946 to \$160,103,550, brings the net increase in the estimates of these four classes of receipts to \$716,665,704, as stated.

The provisions of the Social Security Act, the Bituminous Coal Conservation Act, and the act levying taxes upon carriers and their employees are such that receipts during the fiscal year 1936 will be comparatively small while revenues from these sources in the next fiscal year will show substantial increases. The amounts estimated for 1937 from such new taxes in the order named are \$403,200,000, \$12,500,000, and \$191,600,000.

**Expenditures.**—The expenditures for 1937 contemplated under this Budget will total \$6,709,806,870, or approximately \$265,000,000 less than is now estimated for 1936.

Of the two major categories of expenditure, namely, regular and recovery and relief, allowances for regular activities, including the Agricultural Adjustment Act and Civilian Conservation Corps, amount to \$3,649,781,718 as compared with \$4,770,283,151 for 1936, an increase of \$279,545,387. For recovery and relief, expenditures listed herein are those which will be made from unexpended balances,

practically all of which will have been obligated prior to June 30, 1936, and practically all of which have been allotted. The total of such expenditures in 1937 is estimated at \$1,102,824,632, which is a decrease of \$1,766,243,333 from the figure of \$2,869,068,167 for 1936.

In regular expenditures there is included \$805,000,000 for interest on the public debt, an increase of \$63,000,000 over the same item for the current year; and \$390,125,000 for statutory debt retirements, an increase of \$28,100,000. The cost of service on the public debt in 1937, therefore, will exceed that for 1936 by \$91,100,000.

Excepting debt retirement and interest, the net increase in expenditures for regular activities is \$792,448,557 as compared with 1936. The major part of this increase is accounted for as follows: (a) For financing activities under the Social Security Act, the act levying taxes upon carriers and their employees, and the Bituminous Coal Conservation Act, \$485,000,000; (b) for other new legislation, \$125,000,000; (c) for increased public works, transferred from emergency appropriations, \$228,000,000; (d) for the veterans' adjusted-service certificate fund in order to bring the annual contribution of the Government nearer its actual liability under existing law, \$60,000,000; and (e) for national defense, to meet the policy of the Congress and the Executive in making up for the delay by the United States in bringing the Navy up to the strength contemplated by the naval treaties of 1922 and 1930, and to provide replacement and improved equipment and additional personnel for the Army, \$195,000,000.

In the War Department Appropriation Act for the fiscal year 1935 the Congress adopted a policy of increasing the average enlisted strength of the Army from 118,750 to 165,000 men and toward accomplishing such purpose appropriated an additional \$20,000,000 for expenditure during that year. These funds are sufficient to maintain an average enlisted strength during 1936 of approximately 147,000 men. The estimates of expenditure included in this Budget are sufficient in amount to maintain this average during the fiscal year 1937, with the purpose in view of providing in the 1938 Budget the funds necessary to recruit the Army to such strength by the close of that year as will produce an average enlisted strength of 165,000 throughout the fiscal year 1939, the maximum indicated by the Congress. It is felt that this is as fast as the Government should proceed in this matter in the light of the present forecast of fiscal affairs.

The contemplated expenditures for the Civilian Conservation Corps show a decrease of \$309,283,000 as against estimated comparable expenditures for 1936.

**Deficit and public debt.**—The gross deficit for the fiscal year 1937 is estimated at \$1,095,389,720, including \$283,125,000 for statutory debt retirement, or a net deficit of \$812,264,720. It is estimated that the gross public debt on June 30, 1937, will amount to \$31,351,836,787, as compared with an estimated debt on June 30, 1936, of \$30,935,375,017. The figure for 1937 does not include such amounts for work relief during the coming year as may be determined upon by the Congress.

**Appropriations.**—Appropriations recommended in this Budget aggregate \$6,400,000,000, including probable supplemental items estimated at \$600,000,000, while the appropriations already made and prospective supplemental items for the fiscal year 1936, exclusive of the appropriation of \$4,000,000,000 for recovery and relief, amount to \$5,146,000,000, an increase of \$1,254,000,000 required for the fiscal year 1937 over the fiscal year 1936.

This increase is due to (1) additional appropriations amounting to approximately \$610,000,000, including supplementals to be submitted later, required to finance new legislation enacted at the last session of Congress; (2) an appropriation of \$246,000,000 to continue the operations of the Civilian Conservation Corps from March 31, 1936, to March 31, 1937; (3) an increase in specific appropriations of \$187,000,000 on account of general public works; and (4) increases in the general departmental requirements aggregating approximately \$211,000,000, due largely to the increases in the Army, Navy, and the Department of Agriculture.

Existing authorizations for the Federal-Aid Highway System provide for appropriations of \$125,000,000 for each of the fiscal years 1936 and 1937. Under these authorizations \$40,000,000 has previously been appropriated for the fiscal year 1936. Toward the balance of \$85,000,000 authorized for that year there is provided under the item "General Public Works Program" an estimate of \$60,000,000, which it is believed will be sufficient to meet commitments maturing during 1937. As to the authorization of \$125,000,000 for the fiscal year 1937, language is included in this Budget laying for its purpose the cancellation of this authorization for 1937 and making it applicable to the fiscal year 1938. This course appears fully justified in view of the fact that during the fiscal years 1935 to 1936, inclusive, there has been made available from emergency funds a total of approximately \$1,192,000,000 for the construction of highways and the elimination of grade crossings, and that from these funds there will be available for expenditure during the fiscal year 1937 a total of more than \$250,000,000 in addition to the \$60,000,000 provided for in the General Public Works Program, previously re-

ferred to. Moreover, roads of secondary classification and farm to market roads are being constructed under allotments of emergency funds in amounts approximating \$115,000,000.

The following table shows the approximate estimate of appropriations required to administer new legislation enacted during the last session of Congress, and also shows the amount of receipts anticipated in 1937 from new general tax provisions.

	<i>Estimated appropriations, \$27</i>
Social Security Act.....	\$479,650,840
Railroad Retirement Act.....	47,645,000
Bituminous Coal Conservation Act.....	1,125,000
Amendments, pension laws.....	45,581,132
Postal 40-hour week.....	27,226,429
Elimination diseased cattle.....	17,500,000
Soil conservation.....	27,500,000
Agricultural research and extension.....	11,000,000
Reduction interest rate, Federal land banks.....	10,065,075
<b>Total.....</b>	<b>607,462,467</b>
Estimated receipts from taxes under the Social Security Act, the act levying taxes upon carriers and their employees, and the Bituminous Coal Conservation Act.....	547,100,000

Because there has not been sufficient time to plan the organization and methods required, no detailed estimates are included in the Budget for expense to be incurred by the Social Security Board, and by the Bureau of Internal Revenue for collecting taxes authorized by the three new acts heretofore referred to. However, the probable expense has been approximated and is included in the total lump sum of \$600,000,000 estimated to cover 1937 supplements. The necessary estimates covering the remainder of the current year will be transmitted during the early days of the session, together with complete details for 1937. Likewise no estimate for administering the Potato Act has been prepared since it is believed this act should be amended along lines to be recommended by the Secretary of Agriculture, and a supplemental estimate can then be transmitted.

FRANKLIN D. ROOSEVELT.

JANUARY 3, 1936.

## GENERAL BUDGET SUMMARY AND SUPPORTING SCHEDULES

## GENERAL BUDGET SUMMARY

BALANCED STATEMENT AS REQUIRED BY THE BUDGET AND ACCOUNTING ACT (U. S. C., TITLE 31, SEC. 11 (F))

GENERAL AND SPECIAL ACCOUNTS	Estimated, fiscal year 1957	Estimated, fiscal year 1956	Actual, fiscal year 1955
<b>RECEIPTS:</b>			
1. Revenues (Supporting Schedule No. 1):			
Internal revenue.....	\$5,140,114,000	\$5,874,845,000	\$5,377,660,027.82
Customs.....	354,000,000	352,191,000	343,333,051.50
Miscellaneous revenues.....	155,142,606	178,772,055	168,002,570.86
Total revenues.....	5,649,256,606	6,405,808,055	6,790,045,732.28
2. Realization upon assets.....	4,961,044	2,985,891	10,421,498.70
Total receipts.....	5,654,217,650	6,412,793,946	6,800,467,231.00
<b>EXPENDITURES (Supporting Schedule No. 2):</b>			
1. Legislative, judicial, and executive.....	41,835,027	39,153,180	36,225,190.20
2. Civil departments and agencies.....	1,006,220,145	705,780,103	513,338,167.68
3. National defense.....	927,791,956	744,839,588	533,597,343.04
4. Veterans' pensions and benefits.....	790,058,900	717,522,250	605,578,374.31
5. Agricultural Adjustment Act <sup>1</sup> .....	619,347,000	621,127,000	743,027,311.27
6. Civilian Conservation Corps.....	220,000,000	528,383,000	454,808,643.08
7. Debt charges:			
Interest.....	805,000,000	742,000,000	820,926,333.45
Retirements.....	580,125,000	553,025,000	573,558,250.00
Refunds.....	49,403,100	47,100,000	45,247,672.31
8. Recovery and relief (Supporting Schedules Nos. 2-A, 2-B, and 2-C).....	1,102,824,632	2,859,068,187	3,068,803,052.29
9. Supplemental items (for above groups 1 to 6, inclusive).....	600,000,000	80,000,000	.....
Total expenditures.....	6,752,606,370	7,645,301,338	7,375,825,465.57
<b>DEFICIT</b> .....	1,098,388,720	3,234,507,392	3,575,357,963.61
<b>MEANS OF FINANCING DEFICIT:</b>			
1. Decrease in working balance (general and special accounts, Supporting Schedule No. 3).....			1,262,632,832.06
2. Borrowings (Supporting Schedules Nos. 4 and 5-A).....	1,098,388,720	3,234,507,392	2,312,725,110.05
Total means of financing.....	1,098,388,720	3,234,507,392	3,575,357,963.61

<sup>1</sup>All expenditures under the Agricultural Adjustment Act are included under this heading.

Note.—For receipts and expenditures classified on a daily Treasury statement basis see table No. 1 at the end of this release.

XXIII

**SUPPORTING SCHEDULE No. 1  
RECEIPTS**

(Ordinary revenues and other receipts belonging to general and special accounts, excluding postal revenues)

GENERAL AND SPECIAL ACCOUNTS	Estimated, fiscal year 1937	Estimated, fiscal year 1936	Actual, fiscal year 1936
<b>I. RECEIPTS</b>			
<b>A. General receipts</b>			
(1) Treasury fee	\$1,945,000,000	\$1,484,712,000	\$1,086,218,000
(2) Miscellaneous interest revenue items:			
Bonds fee	389,000,000	187,000,000	145,442,800
102% fee	25,000,000	60,000,000	75,000,000
Capital stock and cross-collateral loans	155,000,000	123,000,000	90,000,000
Alcoholic beverage taxes	554,000,000	502,148,000	517,000,000
Yellow tax	284,000,000	65,700,000	43,138,000
Stamp tax	93,000,000	478,370,000	498,000,000
Manufacturers' excise taxes	303,370,000	364,700,000	341,500,000
Industry tax	90,000,000	90,000,000	138,000,000
<b>Total (unadjusted)</b>	<b>3,959,714,000</b>	<b>3,868,530,000</b>	<b>3,472,662,800</b>
Adjustment to daily Treasury statement	-418,701,000	-418,701,000	-15,700,000
<b>Total miscellaneous interest revenue items</b>	<b>3,541,013,000</b>	<b>3,449,829,000</b>	<b>3,456,962,800</b>
(3) Promoting taxes (Agricultural Adjustment Administration)	647,300,000	558,063,000	1,321,973,612
(4) Other interest revenue items:			
Railroad employees' retirement taxes	351,900,000	33,000,000	
Bibliotax and tax	15,200,000	5,000,000	
Social security taxes (Public Law 371, approved Aug. 14, 1935)	434,200,000		
<b>Total other interest revenue items</b>	<b>801,300,000</b>	<b>38,000,000</b>	
<b>Total general receipts</b>	<b>5,390,314,000</b>	<b>4,974,602,000</b>	<b>4,839,625,412</b>
<b>B. Customs</b>	354,000,000	332,151,000	343,232,000
<b>C. Miscellaneous revenues:</b>			
(1) Miscellaneous loans	3,321,000	4,945,000	5,607,000
(2) Interest, exchange, and dividends	36,079,000	78,124,000	32,707,000
(3) Fines and penalties	7,029,645	1,003,745	6,933,745
(4) Fees	15,753,600	14,398,179	12,554,000
(5) Forfeitures	3,496,000	3,120,413	2,900,000
(6) Royalties	2,917,000	2,294,000	1,431,000
(7) Gifts and contributions	5,267,328	5,574,800	6,020,500
(8) Sales of products	4,410	5,000	110,300
(9) Sales of services	3,914,548	3,043,420	2,802,700
(10) Rents and royalties	26,236,000	26,279,200	22,407,000
(11) Penalties, privileges, and licenses	5,192,585	5,207,000	3,150,000
(12) Permits, privileges, and licenses	3,022,450	1,933,799	1,208,000
(13) Industry receipts	26,337,300	27,260,000	30,000,000
<b>Total (unadjusted)</b>	<b>153,442,900</b>	<b>178,772,000</b>	<b>176,216,600</b>
Adjustment to daily Treasury statement	-153,442,900	-153,442,900	-1,312,500
<b>Total miscellaneous revenues</b>	<b>0</b>	<b>25,329,100</b>	<b>174,904,100</b>
<b>Total revenues</b>	<b>5,390,314,000</b>	<b>5,000,000,000</b>	<b>5,014,539,512</b>
<b>II. RECEIPTS FROM ASSETS</b>			
(1) Dividends of investments	3,000,000	1,000,000	1,000,000
(2) Sales of public lands, Department of the Interior	75,000		50,000
(3) Sales of Government property	1,200,000	2,000,000	2,000,000
<b>Total receipts from assets</b>	<b>4,275,000</b>	<b>3,000,000</b>	<b>3,050,000</b>
<b>Total receipts, general and special accounts</b>	<b>5,394,589,000</b>	<b>5,003,000,000</b>	<b>5,017,589,512</b>

† Daily Treasury Statement basis.

**SUPPORTING SCHEDULE No. 2  
EXPENDITURES**

(Estimated and actual expenditures from general and special accounts)

	Estimated, fiscal year 1937	Estimated, fiscal year 1936	Actual, fiscal year 1936
<b>I. LEGISLATIVE, JUDICIAL, AND EXECUTIVE:</b>			
1. Legislative establishment	\$10,000,000	\$10,000,000	\$10,000,000
2. Judiciary	17,000,000	18,000,000	18,000,000
3. Executive Office	431,000	431,000	437,000
<b>Total, legislative, judicial, and executive</b>	<b>67,000,000</b>	<b>69,150,000</b>	<b>69,200,000</b>
<b>II. CIVIL DEPARTMENTS AND AGENCIES:</b>			
1. Department of Agriculture	902,110,000	100,900,000	82,000,000
2. Department of Commerce	25,530,000	30,000,000	28,000,000
3. Department of Interior	111,525,000	71,120,000	85,111,000
Boulder Canyon project	18,000,000	18,000,000	
4. Department of Justice (except the judiciary, I & 2 above)	25,700,000	18,700,000	25,000,000
5. Department of Labor	24,100,000	15,000,000	15,000,000
6. Department of State	55,700,000	55,000,000	55,000,000
7. Treasury Department (except debt retirement, interest, and refunds VII and VIII below)	102,100,000	144,700,000	147,100,000
8. War Department (military)	141,100,000	79,700,000	57,245,000
Panama Canal	11,200,000	11,200,000	6,700,000
9. Independent Offices and Establishments	65,000,000	64,200,000	64,000,000
10. Tennessee Valley Authority	222,300,000	20,000,000	
11. General public works annual program	40,700,000	40,000,000	31,000,000
12. Interdepartmental, civil, Canal Zone, and Foreign Service (Government share)	79,500,000	50,000,000	60,000,000
13. Post Office Department, deficiency (from Annual Budget)	5,700,000	5,700,000	5,700,000
14. District of Columbia, contribution (from Annual Budget)	5,700,000	5,700,000	5,700,000
Unallocated items			
Appropriation outstanding other's checks outstanding			-2,410,000
<b>Total civil departments and agencies</b>	<b>1,006,230,100</b>	<b>720,700,000</b>	<b>613,500,100</b>
<b>III. NATIONAL DEFENSE:</b>			
1. Navy Department	307,312,000	426,200,000	341,400,000
2. War Department	386,370,000	316,000,000	252,180,000
<b>Total national defense</b>	<b>693,682,000</b>	<b>742,200,000</b>	<b>593,580,000</b>
<b>IV. VETERAN'S BENEFITS AND SERVICES:</b>			
Veterans' Administration	790,000,000	717,000,000	605,570,000
<b>V. AGRICULTURAL ADJUSTMENT ADMINISTRATION:</b>			
Refunds of promoting taxes	377,547,000	306,127,000	711,810,100
Miscellaneous	42,000,000	32,000,000	57,200,000
<b>Total, Agricultural Adjustment Act</b>	<b>420,547,000</b>	<b>338,127,000</b>	<b>769,010,100</b>
<b>VI. CITIZEN CONSERVATION CORPS:</b>			
Total	222,000,000	228,000,000	435,000,000
<b>VII. DEBT CHARGES:</b>			
1. Interest	165,000,000	112,000,000	801,400,000
2. Refinancing	160,125,000	542,000,000	270,500,000
<b>Total debt charges</b>	<b>325,125,000</b>	<b>654,000,000</b>	<b>1,071,900,000</b>
<b>VIII. EXPENSES:</b>			
1. Customs	17,000,000	13,000,000	20,715,000
2. Internal revenues	33,000,000	33,000,000	34,331,000
<b>Total, internal</b>	<b>50,000,000</b>	<b>46,000,000</b>	<b>55,046,000</b>
<b>IX. RECOVERY AND RELIEF:</b>			
1. Agricultural aid:			
(a) Community Credit Corporation	140,000,000	101,000,000	81,144,000
(b) Farm Credit Administration (including Federal Farm Mortgage Corporation)	24,000,000	25,000,000	24,000,000
(c) Federal land banks	84,000,000	85,000,000	85,000,000
<b>Total, agricultural aid</b>	<b>248,000,000</b>	<b>211,000,000</b>	<b>190,144,000</b>
2. Relief:			
(a) Federal Emergency Relief Administration (including Federal Surplus Relief Corporation)	404,201,000	5,814,000,000	5,814,000,000
(b) Civil Works Administration	400,100,000	11,000,000	11,000,000
(c) Drought-stricken areas (Department of Agriculture)	4,200,000	80,000,000	80,000,000
<b>Total relief</b>	<b>808,501,000</b>	<b>5,905,000,000</b>	<b>5,905,000,000</b>

\* Excess of credits, below.  
† General Public Works Program estimate distributed to various departments and establishments in items I to IV.

SUPPORTING SCHEDULE No. 2—Continued  
EXPENDITURES—Continued

GENERAL AND SPECIAL ACCOUNTS	Estimated, fiscal year 1937	Estimated, fiscal year 1936	Actual, fiscal year 1937
<b>CC. Emergency and relief—Continued.</b>			
<b>a. Public works:</b>			
(1) Administrative expenses, Public Works Administration.....	\$13,000,000	\$20,000,000	\$14,561,215.20
(2) Boulder Canyon project.....	9,100,000	13,710,000	23,829,875.54
(3) Loans and grants to States, municipalities, etc.....	225,710,000	25,400,000	127,797,677.44
(4) Public highways.....		45,000,000	36,239,723.31
(5) River and harbor works.....	220,518,000	270,543,000	217,345,043.86
(6) Rural Electrification Administration.....	84,611,000	150,510,000	117,634,711.31
(7) Works Progress Administration.....	2,500,000	5,000,000	15,923.50
(8) Other public works (national defense, public buildings, etc.).....		420,735,400	512,738,647.82
<b>Total, public works.....</b>	<b>597,969,722</b>	<b>1,869,992,700</b>	<b>1,825,671,648.54</b>
<b>b. Aids to farm owners:</b>			
(1) Home loan system.....		27,412,320	75,696,734.88
(2) Emergency housing.....	41,800,000	48,000,000	5,479,221.17
(3) Federal Housing Administration.....	30,000,000	34,662,360	15,959,473.52
(4) Resettlement Administration.....	150,000,000	75,200,000	3,741,668.88
(5) Automobile home loans.....		800,000	2,461,407.71
<b>Total, aids to farm owners.....</b>	<b>221,800,000</b>	<b>194,180,980</b>	<b>128,338,906.16</b>
<b>c. Miscellaneous:</b>			
(1) Export-Import Banks of Washington.....	10,950,000	17,118,000	* 2,816,096.43
(2) Federal Deposit Insurance Corporation.....			697,890.55
(3) Administrator for industrial recovery.....		5,200,000	12,409,730.55
<b>Total, miscellaneous.....</b>	<b>10,950,000</b>	<b>22,318,000</b>	<b>16,273,968.53</b>
<b>d. Reconstruction Finance Corporation:</b>			
1. Tennessee Valley Authority.....	* 125,000,000	* 215,000,000	* 135,296,625.00
2. Unimpaired funds available, Oct. 31, 1933 and thereafter.....	225,000,000	275,000,000	26,148,427.19
<b>Total, recovery and relief.....</b>	<b>1,152,629,722</b>	<b>2,989,992,180</b>	<b>2,095,918,522.19</b>
<b>II. Miscellaneous items.....</b>	<b>600,000,000</b>	<b>84,000,000</b>	
<b>Total, expenditures.....</b>	<b>1,752,629,722</b>	<b>3,074,000,180</b>	<b>2,079,520,145.17</b>

\* Items of credit, debit.

SUPPORTING SCHEDULE No. 2-A

MONIES APPROPRIATED AND ALLOCATED FOR RECOVERY AND RELIEF—TOTAL AMOUNTS PROVIDED TO OCT. 31, 1935

Administrative title	Purpose	Local reference	From specific appropriations	Allocations under National Industrial Recovery Act	From Emergency Appropriation Act	From Emergency Relief Appropriation Act	From Reconstruction Finance Corporation funds	Total amounts provided to Oct. 31, 1935
<b>Agricultural aid:</b>								
Agricultural Adjustment Administration.....	Corn, sugar, etc.	June 16, 1933, 48 Stat. 275.		\$21,344,000.00				\$21,344,000.00
Commodity Credit Corporation.....	Capital stock.	Oct. 25, 1933, no. 6301.	5,000,000.00					5,000,000.00
Do.....	Loans.	Jan. 22, 1932, no. amended.				\$100,000,000.00		100,000,000.00
Farm Credit Administration.....	Cotton.....	June 16, 1933, 48 Stat. 275.	45,000,000.00					45,000,000.00
Do.....	Production Credit Corporation.	June 16, 1933, 48 Stat. 280.	\$45,000,000.00					\$45,000,000.00
Do.....	Crop production and harvesting loans.	Mar. 10, 1934, 48 Stat. 452.	40,000,000.00					40,000,000.00
Do.....	Seed and seed loans.	June 25, 1934, no. 4747.				\$25,000,000.00		25,000,000.00
Do.....	Seed and seed loans.	Aug. 20, 1934.*				71,790,000.00		71,790,000.00
Do.....	Seed and seed loans.	Mar. 22, 1935.*				30,000,000.00		30,000,000.00
Regional Agricultural Credit Corporation.....	Stock and expenses.	July 21, 1932, 47 Stat. 711.					\$9,248,387.00	\$9,248,387.00
Crop loans.....	Crop loans.....	Jan. 22, 1932, no. amended.				75,000,000.00		75,000,000.00
Federal intermediate credit banks.....	Capital stock, paid-in surplus.	Jan. 22, 1934, 48 Stat. 268.				40,000,000.00		40,000,000.00
Farm Credit Administration.....	Production Credit Corporations and crop-production loans.	June 16, 1933, 48 Stat. 278.				45,000,000.00		45,000,000.00
Joint-stock land banks.....	Loans for liquidation.	May 12, 1935, 49 Stat. 46.				100,000,000.00		100,000,000.00
Loans to farmers.....	Loans for refinancing secured by mortgages.	May 21, 1935, 49 Stat. 48.				200,000,000.00		200,000,000.00
Federal Farm Mortgage Corporation.....	Federal land banks:							
Capital stock.....	Purchase of stock.	Feb. 2, 1932, 47 Stat. 55.	120,000,000.00					120,000,000.00
Paid-in surplus.....	Subscriptions.....	June 16, 1933, 48 Stat. 279.	40,000,000.00					40,000,000.00
Do.....	do.....	June 25, 1934, 48 Stat. 1900.	75,000,000.00					75,000,000.00
Do.....	do.....	Aug. 13, 1935, 49 Stat. 392.	30,000,000.00					30,000,000.00
Reduction in interest on farm mortgages.....	Reduction in interest rates.	June 16, 1933, 48 Stat. 278.	15,000,000.00					15,000,000.00
Do.....	do.....	June 10, 1934, 48 Stat. 1000.	7,400,000.00					7,400,000.00
Do.....	do.....	Aug. 12, 1935, 49 Stat. 392.	38,000,000.00					38,000,000.00
<b>Total, agricultural aid.....</b>			<b>409,000,000.00</b>	<b>120,344,000.00</b>	<b>140,760,000.00</b>		<b>1,000,000,777.16</b>	<b>1,670,804,777.16</b>

1 Date of act except as otherwise indicated.

2 Reproductive order.

3 Not after delinquent repayments to the Reconstruction Finance Corporation.

\*Miscellaneous.







## SUPPORTING SCHEDULE No. 2-C—Continued

## MONEYS FOR RECOVERY AND RELIEF CLASSIFIED AS TO PROVISIONS FOR REPAYMENT—Continued

Classification	Total amounts provided to Oct. 31, 1937	Expenditures				Unexpended
		Fiscal year 1935 to Oct. 31, 1935	Fiscal year 1935	Fiscal year 1936 and prior years	Total to Oct. 31, 1937	
<b>II. DEBITABLE</b>						
<b>A. Federal public-works projects</b>						
Boulder Canyon project	\$75,484,390.33	\$5,964,814.12	\$25,322,327.94	\$78,443,297.94	\$26,654,323.86	\$28,201,227.61
Other reclamation projects	172,397,000.00	4,299,296.18	15,644,926.42	3,698,090.54	27,377,289.68	54,521,766.82
Total Federal public-works projects	247,881,390.33	10,264,110.30	40,967,254.36	82,141,388.48	54,031,613.54	82,723,014.43
<b>B. Loans</b>						
Community Credit Corporation	596,232,260.00	511,627,221.89	* 66,144,964.86	169,241,936.46	226,220,251.79	296,697,127.80
Federal stock land banks	490,000,000.00	- 66,123.17	- 66,123.17	942,644.85	- 9,422.90	160,000,123.80
Crop and feed loans, etc. (Farm Credit Administration)	124,208,000.00	* 11,461,972.22	68,891,240.24	* 4,022,662.29	73,994,896.13	82,423,663.69
Public Works Administration:						
Public works	642,252,230.64	* 49,349,742.06	106,263,194.46	- 60,333,044.43	172,541,498.62	471,011,123.23
Refunds	286,626,556.99	* 21,461,626.77	66,230,732.29	76,720,090.90	113,078,127.19	36,342,729.02
Emergency housing	125,022,730.00	15,485,046.07	8,629,873.47	202,251.41	17,284,234.94	109,446,544.22
Federal Housing Administration	33,000,000.00	8,369,022.03	15,363,473.20		23,692,745.07	34,086,228.02
Home loan banks	6,511,000.00	412,212.70	2,895,327.21	2,272,122.89	3,440,022.29	361,209.02
Communitarian Finance Corporation	4,000,000,000.00	39,654,663.28	* 12,212,873.64	2,184,715,190.20	2,172,130,393.62	1,021,822,022.12
Fiscal-Deposit Banks of Washington	20,750,000.00	7,236,357.69	* 2,616,426.62	3,654,226.15	7,504,170.20	21,245,829.80
Farm Electrification Administration	7,804,612.00					7,804,612.00
Home Owners Administration	173,308,266.20	6,714,118.95	1,029,872.02		8,743,990.97	164,594,275.23
Total loans	5,983,606,875.28	149,456,656.38	168,756,652.34	2,496,071,926.27	2,724,120,452.92	3,797,677,420.29
<b>B. Subscriptions in capital stock, etc.</b>						
Production credit corporations	120,000,000.00		15,000,000.00	140,000,000.00	120,000,000.00	
Stocks for reforestation	128,000,000.00	3,000,000.00	15,000,000.00	10,000,000.00	128,000,000.00	
Regional agricultural credit corporations	44,500,000.00			44,500,000.00	44,500,000.00	
Federal Farm Mortgage Corporation	200,000,000.00		203.82	190,996,734.20	900,000,000.00	
Federal intermediate credit banks	90,000,000.00		15,000,000.00	25,000,000.00	40,000,000.00	
Federal land banks	270,000,000.00	71,260,234.94	24,300,222.30	162,806,162.10	231,749,814.80	20,225,187.11
Home loan banks	125,000,000.00	7,150,000.00	300,000.00	81,448,700.00	56,750,700.00	36,234,297.00
Home Owners Loan Corporation	200,000,000.00		40,000,000.00	124,000,000.00	200,000,000.00	
Federal savings and loan associations	30,000,000.00	19,494,741.47	23,420,704.08	224,620.00	49,230,222.55	704,674.44
Federal Deposit Insurance Corporation	150,000,000.00		467,800.25	149,532,199.75	150,000,000.00	
Total subscriptions	1,225,000,000.00	46,441,026.41	156,754,225.64	1,694,685,526.14	1,221,280,888.24	66,213,101.76
Total repayable	7,498,672,822.91	214,697,682.91	364,970,277.44	2,842,662,898.72	4,905,642,232.11	5,464,352,666.80
<b>III. UNREPAYABLE FUNDS</b>						
By the President	10,000,000.00					10,000,000.00
By Public Works Administration	12,262,188.74					12,262,188.74
Grand total	17,262,188.74	1,115,891,712.00	3,565,926,624.38	4,165,762,911.28	10,812,671,695.14	6,530,674,798.62

\* Excess of credits, debits.

NOTE.—Expenditures shown in this statement under the headings Agricultural Adjustment Administration, Emergency Conservation Work, and Federal land bank capital stock, for the fiscal year 1937 in the total amount of \$422,121,861.16 are credited in the General Budget Summary and Supporting Schedule No. 2 to specific expenditures.

## SUPPORTING SCHEDULE No. 3

## GENERAL FUND BALANCE

The general fund balance, as shown on the Unity Statement of the United States Treasury, comprehends the balance in the general, special, and trust accounts mentioned. The amounts are both in-line balances and balances due the working balances in the General Budget Summary is mentioned.

	Estimated, fiscal year 1937	Estimated, fiscal year 1936	Actual, fiscal year 1935
<b>Balance in general fund at beginning of year:</b>			
Working balances	\$46,226,128	\$46,226,128	\$1,520,000,001.00
General and special accounts	167,914,942	162,203,000	96,457,491.49
Trust accounts	420,000,000	420,000,000	
Checking accounts of Government agencies			
Total working balances	1,009,172,140	1,009,143,602	1,776,546,492.49
Increment on gold	240,000,000	240,000,147	451,274,706.72
Expenses	218,000,000	240,112,442	
Total general fund balance	1,031,172,140	1,049,031,207	2,227,821,199.21
<b>Change (+) or decrease (-) in general fund balance during year:</b>			
Working balances			-1,262,632,632.50
General and special accounts (Supporting Schedule No. 2)	+12,984,211	+4,467,879	+423,706,471.00
Trust accounts	-10,000,000	-4,200,700	+426,206,748.00
Checking accounts of Government agencies			
Total increase (+) or decrease (-) in working balances	+2,984,211	-4,200,700	-798,699,413.50
Increment on gold	+140,000,000	+140,000,147	+111,284,000.00
Expenses	-140,000,000	-140,112,442	-140,112,442.47
Total increase (+) or decrease (-) in general fund balance	+1,044,172,140	+1,044,831,207	+1,044,831,207.21
<b>Balance in general fund at end of year:</b>			
Working balances	428,226,128	428,226,128	428,226,128.00
General and special accounts	167,914,942	162,203,000	162,203,000.00
Trust accounts	420,000,000	420,000,000	420,000,000.00
Checking accounts of Government agencies			
Total working balances	1,016,141,070	1,010,429,128	1,010,429,128.00
Increment on gold	240,000,000	240,000,147	240,000,147.00
Expenses	218,000,000	240,112,442	240,112,442.47
Total general fund balance	1,038,141,070	1,010,316,833	1,010,316,833.57

## Increment on gold resulting from reduction in weight of gold dollar

	1927	1936	1937
Receipts			\$1,728,918.62
Expenditures:			
Minting issues, etc.	\$200,000	\$201,147	675,122.00
Payment to Federal Reserve banks for initial loan	4,726,000	4,726,000	26,991,622.34
Withdrawal of national bank notes	140,000,000	140,000,000	67,615,000.00
Total expenditures	145,000,000	144,927,147	135,281,744.34
Net expenditures	144,800,000	144,726,000	133,552,825.72

**SUPPORTING SCHEDULE No. 4**  
**EFFECT ON THE PUBLIC DEBT OF FINANCING THE DEFICIT**

	Estimated, fiscal year 1937	Estimated, fiscal year 1936	Actual, fiscal year 1936
Public debt at beginning of year (Supporting Schedule No. 3-A).....	\$20,923,375,637	\$20,700,923,630	\$21,023,141,414
Increase in public debt during year:			
To meet the deficiency in revenues and receipts, general and special accounts.....	1,008,360,720	1,234,607,302	1,533,237,962
Less debt retirements included in deficit.....	680,133,000	552,029,000	573,228,250
Increase in working balances (+) decrease (-), general and special accounts (Supporting Schedule No. 3).....	458,365,720	1,021,462,200	1,001,796,712
Total increase in public debt during year to finance deficit.....	786,593,440	1,704,040,502	1,961,806,424
Decrease in public debt during year due to national bank note retirements chargeable against increment in gold.....	-190,000,000	-430,000,000	-21,432,450
Net increase in public debt during year.....	596,593,440	1,274,040,502	1,940,373,974
Public debt at end of year.....	\$21,520,000,000	\$21,974,964,132	\$22,963,515,388

**SUPPORTING SCHEDULE No. 5-A**  
**PUBLIC DEBT OF THE UNITED STATES GOVERNMENT**

	Outstanding debt		Increase during fiscal year 1937	Outstanding debt June 30, 1936
	June 30, 1936	June 30, 1937		
<b>1. DEBT BEARING INTEREST:</b>				
1. Free-war bonds, including postal savings bonds.....	\$62,265,475.00	\$62,226,375.00	\$38,513,100.00	\$73,944,825.00
2. Liberty Loan bonds.....	1,224,977,000.00	2,243,774,220.00	1,018,800,000.00	2,261,822,900.00
3. Treasury bonds.....	12,403,520,300.00	8,722,722,550.00	2,331,027,500.00	8,126,960,000.00
4. United States Savings bonds.....	63,647,818.75		63,647,818.75	
Total bonds.....	14,354,410,593.75	11,588,823,145.00	1,874,057,731.25	12,111,228,725.00
5. Treasury notes.....	26,265,265,000.00	2,261,200,000.00	2,261,200,000.00	2,261,200,000.00
6. Certificates of indebtedness.....	152,500,000.00	1,624,040,000.00	1,471,540,000.00	1,294,550,000.00
7. Treasury bills (contingent value).....	2,462,500,000.00	1,494,000,000.00	968,500,000.00	120,514,000.00
Total interest-bearing debt outstanding.....	37,644,741,063.75	26,469,063,145.00	1,194,733,218.75	16,991,892,725.00
<b>2. MATURED DEBT OF WHICH INTEREST HAS CEASED (PAYABLE ON PRESENTATION):</b>				
1. DEBT BEARING NO INTEREST (PAYABLE ON PRESENTATION):				
Total gross debt.....	36,700,000,000.00	27,053,141,614.48	16,185,268,001.48	
Less balance held by Treasurer, United States, June 30.....	1,842,342,626.47	2,261,921,240.18	1,740,578,700.69	228,467,108.11
Gross debt less net balance in general account, on basis of daily Treasury statement, reported.....	34,857,657,373.53	24,791,220,374.30	14,444,689,290.89	
Less interest obligations, etc., reported.....	745,236,000.00	273,690,000.00	471,546,000.00	112,627,644.40
Adjustment in balance held by Treasurer, United States, June 30, due to excess of disbursements over receipts in reports subsequently received.....	26,524,273.21	20,617,494.74	100,776.47	2,424,262.09
Less excess of redemptions over receipts in transit, etc., June 30.....		55,428.95	15,428.95	1,622.20
Add excess of receipts over redemptions in transit, etc., June 30.....	274,467.23		274,467.23	
Net debt, on basis of daily Treasury statement, reported.....	37,434,472,148.73	24,774,078,046.87	14,069,868,106.81	15,998,983,526.71

<sup>1</sup> Decrease.

Supporting Schedule No. 5-B

CONTINGENT LIABILITIES OF THE UNITED STATES GOVERNMENT

	Anticipating an	Amount of contingent liability on June 30, 1936		
		Projected	Estimated	Total
<b>I. OBLIGATIONS OF THE DISTRICT COURTS:</b>				
1. Federal Trust, Mortgage Corporation	Jan. 15, 1935 (H. Rept. 244) as amended	\$1,522,000,000.00	\$7,871,147.00	\$1,529,871,147.00
2. Federal Housing Administration	June 25, 1934 (H. Rept. 294)	15,947,232,622.87	1,048,262,832.27	17,000,000,000.00
3. Home Owners' Loan Corporation	June 15, 1934 (H. Rept. 128) as amended	243,771,995.87	4,254,706.15	248,026,702.02
4. Homeowner-Fluorine Corporation	Jan. 25, 1935 (H. Rept. 2) as amended			
Total, bond issue obligations		17,713,004,622.74	13,174,116.42	17,726,178,739.16
<b>II. OBLIGATIONS OF THE DISTRICT COURTS:</b>				
1. Secretary of Agriculture (contingent)	Dec. 4, 1934 (H. Rept. 20) (H. Rept. 311)	42,000,000.00	45,000.00	42,450,000.00
2. Trust Corporation, Florida Gas Depository	June 25, 1934 (H. Rept. 128) as amended	1,244,202,200.00	20,994,022.07	1,265,196,222.07
3. Tennessee Valley Authority	Dec. 16, 1934 (H. Rept. 2) (H. Rept. 31)			
Total, bond issue obligations		1,286,202,200.00	21,039,022.07	1,307,241,222.07
<b>III. OTHER OBLIGATIONS:</b>				
1. Federal Reserve Bank (New Mexico)	Dec. 21, 1933 (H. Rept. 20) as amended			\$1,250,000.00

MEMORANDUM

CONTINGENT LIABILITY FROM DISTRICT COURTS:

Federal Trust, Mortgage Corporation (see I above)  
 Home Owners' Loan Corporation (see I above)  
 Homeowner-Fluorine Corporation, after deducting of \$1,000,000 from amount of bonds and accrued interest thereon, held by U. S. Treasury and referred to the public debt in part 3 of this schedule (see I above)  
 Tennessee Valley Authority (see I above)

CONTINGENT LIABILITY FROM DISTRICT COURTS:

Secretary of Agriculture (see II above)  
 Trust Corporation, Florida Gas Depository (see II above)  
 Tennessee Valley Authority (see II above)  
 For title A, Agricultural Adjustment Act.  
 For title A, National Housing Act.

Secretary of Agriculture:

Secretary of State on letters (see I above)

- 1. After deducting amounts of funds deposited with the Treasury in trust interest payments.
- 2. Contingent liability on bonds and securities.
- 3. Includes \$1,000,000 which represents interest on \$70,000,000 face amount of bonds and certain receipts outstanding, guaranteed as to interest only.
- 4. \$100,000,000 face amount of bonds and accrued interest thereon, held by Treasury and referred to the public debt in part 3 of this schedule.
- 5. Amounts reported by the Secretary of Agriculture pursuant to sec. 4 of the act of May 15, 1935 upon returns in Memorandum to Congress on the whole payment example to the Secretary of Agriculture.
- 6. Offset by cash in Departmental Treasury funds amounting to \$20,000,000 which is shown by the pledge of collateral as provided in the Federal Reserve Act and in the act of May 15, 1935.
- 7. Total estimated receipts of \$20,000,000 estimated from deposits in the Treasury and \$20,000,000 of this one Federal Reserve note held by the issuing bank. Federal Reserve notes issued by the Treasury are estimated in the amount of \$2,000,000,000. United States Government securities of a face value of \$20,000,000 and commercial paper of a face value of \$1,000,000.

Maximum estimated total of obligations \$1,980,000,000.00  
 4,700,000.00  
 1,984,700,000.00

ANALYSIS OF REVENUE ESTIMATES

The revenues of the Federal Government are mainly dependent upon the tax structure and the level of business activity. Hence, in the preparation of revenue estimates in November of each year, the Treasury is required, pending the continuance of the then existing tax structure, to forecast the probable trend of business activity for the ensuing 20 months—the period covering the remainder of the then current fiscal year and the next fiscal year.

Because of Federal practices in the collection of taxes, Federal revenues do not promptly reflect changes in business conditions. During a fiscal year income tax collections are for the most part derived from income of the two calendar years ending with December of the fiscal year. Thus, collections of income taxes during the latter half of the current fiscal year will be based upon the business volume of the calendar year 1935 and collections during the fiscal year 1937 will reflect the business volume of the calendar years 1935 and 1936. Because of this lag in collections, receipts from income taxes are expected to provide a much larger proportion of total revenues as business activity increases. Collections from estate and gift taxes also lag behind changes in general business conditions, whereas most of the other sources of miscellaneous internal revenue taxes and customs duties reflect such changes almost immediately.

TOTAL ESTIMATED REVENUES

Total receipts, general and special accounts, are estimated (on Treasury statement basis) in the amounts of \$4,411,000,000 for the fiscal year 1936 and \$5,654,000,000 for the fiscal year 1937, or increases of \$610,000,000 and \$1,244,000,000, respectively, over the actual receipts for the fiscal year 1935.

Total receipts from customs and internal revenue, exclusive of the agricultural adjustment taxes, taxes upon carriers and their employees, the bituminous coal tax, and the social security taxes, are estimated at \$3,660,000,000 for the fiscal year 1936 and \$4,400,000,000 for the fiscal year 1937. These amounts represent increases of \$560,000,000 and \$1,300,000,000, respectively, over the amounts received from these sources for the fiscal year 1935.

Receipts from taxes levied under the Agricultural Adjustment Act, as amended, and related legislation are estimated (on Treasury statement basis) at \$570,000,000 for the fiscal year 1936, an increase of \$8,000,000 over receipts for 1935. New sources of revenue, taxes upon carriers and their employees, and the bituminous coal tax, are estimated to yield \$30,000,000 and \$6,000,000, respectively, in the fiscal year 1936. Miscellaneous revenues and receipts from the realization upon assets are estimated at \$183,000,000.

For the fiscal year 1937, receipts from the Agricultural Adjustment Act taxes and the taxes on cotton ginning and tobacco sales are estimated at \$547,000,000; taxes upon carriers and their employees at \$102,000,000; and the bituminous coal tax at \$12,000,000. Receipts from the social security taxes, which will be collected for the first time in the latter half of the fiscal year 1937, are estimated at \$433,000,000. Miscellaneous revenues and receipts from realization upon assets are estimated at \$160,000,000.

For the years up to 1932 approximately one-third of the revenue from taxable sources came from cus-

tom duties and miscellaneous internal revenue laws and about two-thirds from income taxes. By the fiscal year 1934 the proportion of revenue from income taxes had declined to less than one-third as a result of the severe decline in incomes during the depression years and the new and additional taxes on miscellaneous sources imposed by the Revenue Act of 1932 and subsequent acts. In the fiscal year 1935 the proportion of internal revenue derived from income taxes increased because of larger incomes and the partial effect of the Revenue Act of 1934 which provided for higher tax yields, and because collections from miscellaneous internal revenue taxes, with the exception of distilled spirits, increased only moderately. With a continuance of business recovery, receipts from income taxes may be expected to provide an increasing proportion of internal revenue.

EFFECTS OF RECENT REVENUE LEGISLATION

Revenue legislation in the last session of Congress which affects revenue in the fiscal years 1936 and 1937 includes: (1) The extension to June 30 or July 31, 1937, of title IV, as amended, of the Revenue Act of 1932; (2) an act to amend the Agricultural Adjustment Act; (3) an act to levy an excise tax upon carriers and an income tax upon their employees; (4) the Bituminous Coal Conservation Act of 1935; (5) the Social Security Act; and (6) the Revenue Act of 1935.

The extension for two years, or until June 30 or July 31, 1937, of the temporary miscellaneous internal revenue taxes, additional customs duties, and changes in rates and exemptions imposed by the Revenue Act of 1932, as amended, is estimated to produce \$415,000,000 in the fiscal year 1936 and \$502,000,000 in the fiscal year 1937. The smaller amount for 1936 is mainly due to the fact that collections would have been received during July and, in some cases, during August 1935 if those taxes had not been extended.

The act to amend the Agricultural Adjustment Act, approved August 24, 1935, imposed a tax upon the processing of rice, effective September 1, 1935, and a tax upon the first sale of potatoes harvested on or after December 1, 1935. The tax on rice is expected to yield about \$2,000,000 in the fiscal year 1936 and \$3,000,000 in the fiscal year 1937. No appreciable amount of revenue is expected from the tax on potatoes.

The act to levy an excise tax upon carriers and an income tax upon their employees became effective March 1, 1936, and terminates February 28, 1937. It is estimated that these taxes will yield \$33,000,000 in the fiscal year 1936 and \$102,000,000 in the fiscal year 1937. Revenue from the bituminous coal tax imposed by the Bituminous Coal Conservation Act, approved August 30, 1935, is expected to amount to \$12,000,000 in the fiscal year 1936 and \$12,000,000 in the fiscal year 1937.

Under the Social Security Act, approved August 14, 1935, title VIII imposes an excise tax on employers and an income tax on their employees, effective January 1, 1937, which are expected to yield \$305,000,000 in the 1937, which are expected to yield \$305,000,000 in the latter half of the fiscal year 1937. Title IX of the Act, which provides for an excise tax on employers of eight or more persons, becomes effective January 1, 1936, and

collections from this tax will not be received until January 1937. It is estimated that this tax will provide \$125,000,000 of revenue in the fiscal year 1937.

The effect of the Revenue Act of 1935 will be only partially reflected in revenue for the fiscal year 1937. The changes in the act in respect to income taxes and gift taxes apply to incomes and gifts of the calendar year 1937 and succeeding years. Therefore, additional revenue from these sources, resulting from provisions of the act, will not be received until the second half of the fiscal year 1937. The revisions made in estate tax provisions will not appear in receipts until December 1936 because, although the changes became effective upon the date of passage of the act, August 30, 1935, returns are not required to be filed until 15 months after death. The changes in the act in respect to the capital-stock tax and excess profits tax will be fully reflected in collections of the fiscal year 1937. The following table summarizes estimated increases in receipts during the fiscal year 1937 due to the Revenue Act of 1935:

(In millions of dollars)	
Income taxes:	
Current corporations	42
Current individual	62
Excess profit taxes	22
Capital stock and excess profits taxes	80
Total	226

#### REVENUE ESTIMATES FOR THE FISCAL YEAR 1938

Total receipts from customs and internal revenue, exclusive of agricultural adjustment taxes, taxes upon carriers and their employees, and the bituminous coal tax for the fiscal year 1938 are estimated (on Treasury statement basis) at \$3,660,000,000, an increase of \$560,000,000 over receipts of the fiscal year 1935, as shown in statement no. 1. The major sources of these revenues are summarized as follows:

(In millions of dollars)		
	Actual, 1935	Estimated, 1938
Income taxes	1,999.1	2,144.1
Excess profits and gift taxes	1,027.2	1,172.2
Customs	243.4	255.3
Total	3,269.7	3,571.6

The estimated increases are the results of improvement in business conditions and changes in respect to income taxes and estate taxes incorporated in the Revenue Act of 1935.

**Income taxes.**—Collections from current corporate income taxes are estimated at \$615,000,000, an increase of \$150,000,000 over collections of the fiscal year 1935. Collections from current individual income taxes are estimated at \$829,000,000, an increase of \$181,000,000 over collections of the fiscal year 1935.

Collections from back taxes are estimated in 1937, \$160,000,000, an increase of \$4,000,000 over collections of the fiscal year 1935. The high level of collections from this source is expected to continue because of the special efforts of the Bureau of Internal Revenue to collect back taxes and the changed policy of the Treasury in respect to its administration of depreciation allowances.

**Miscellaneous internal revenue.**—Revenue from taxes on capital stock, excess profits, estates, and gifts is estimated in the amount of \$355,000,000, an increase of \$43,000,000 over collections for 1935. The gain is chiefly the result of an estimated increase in estate tax collections in consequence of estimated higher values of estates and the Revenue Act of 1934, which will be fully reflected in collections in the fiscal year 1936.

Revenue from distilled spirits, wines, and fermented liquors is estimated at \$503,000,000, an increase of \$92,000,000 over the preceding year. The increase is mainly accounted for by an expected increase in the consumption of distilled spirits, as a result of improving quality, lower prices, enforcement activity and increasing incomes. Collections from taxes on tobacco manufactures are estimated at \$475,000,000, an increase of \$10,000,000 over collections of 1935. The gain is attributed to an expected moderate increase in the consumption of small cigarettes. The estimated increase of \$24,000,000 in documentary stamp tax collections reflects estimated increases in refunding of security issues and greater activity in trading on the stock exchanges.

Revenue from manufacturers' excise taxes is estimated at \$765,000,000, an increase of \$23,000,000 over collections of 1935. Miscellaneous taxes are expected to yield \$90,000,000, or \$16,000,000 less than collections of 1935. This decline is the net result of loss in revenue due to the repeal of the tax on checks, effective January 1, 1935, and estimated increases in other sources of revenue under this classification.

Changes in estimated collections from principal sources of miscellaneous internal revenue in the fiscal year 1938, as compared with actual collections in the fiscal year 1935, are summarized in the following table:

Receipts from principal sources of miscellaneous internal revenue			
Source	The estimate of 1938		Difference (1938 estimate minus 1935 actual)
	Actual, 1935	Estimated, 1938	
Capital stock and excess profits taxes	46.1	122.1	+76.0
Estate and gift taxes	63.2	211.2	+148.0
Distilled spirits and wines, including fermented and carbonated liquors, including malted liquors	108.4	200.4	+92.0
Tobacco manufactures	513.0	523.0	+10.0
Documentary stamp taxes	40.2	64.2	+24.0
Manufacturers' excise taxes	765.0	788.0	+23.0
All other	116.2	90.2	-26.0
Total miscellaneous internal revenue	1,671.9	1,997.9	+326.0

**Agricultural adjustment taxes.**—Collections from taxes levied under the Agricultural Adjustment Act and related legislation are estimated to yield \$524,000,000, or \$2,000,000 less than collections of the fiscal year 1935. This decline is accounted for by estimated decreases from taxes on the processing of hops, tobacco (due to a decrease in rates of tax effective Oct. 1, 1935), and sugar in excess of estimated gains from the taxes on the processing of wheat, corn, peanuts, and rice. The processing tax on rice, which was not effective in the fiscal year 1935, is expected to yield \$2,000,000. The processing taxes on certain paper and pulp products and the taxes on cotton ginning and on tobacco sales are expected to show slight change.

**Other internal revenue taxes.**—Collections from taxes upon carriers and their employees are estimated at \$3,000,000. This tax becomes effective March 1, 1936, and only one quarterly payment will be received in the fiscal year 1936. Under the act to levy an excise tax upon carriers and an income tax upon their employees, an excise tax is imposed on carriers equal to 3½ percent of the compensation (not in excess of \$300 per month) paid by it to its employees and an income tax of 3½ percent of the compensation (not in excess of \$300 per month) is imposed on each employee as defined by the Act.

The Bituminous Coal Conservation Act of 1935 levies a tax of 15 percent on the sale price of bituminous coal at the mine, with the provision that coal producers also accept the Bituminous Coal Code shall be entitled to a credit of 90 percent of the amount of the tax. Revenue under this act is expected to commence January 1, 1936, and collections during the latter half of the fiscal year 1936 are estimated at \$9,000,000.

**Customs receipts.**—Customs receipts (on collection basis) are estimated in the amount of \$352,000,000, or \$7,000,000 more than collections in 1935. Revenue from duties on distilled spirits and wines is estimated to decline \$8,000,000 from the collections of 1935, chiefly in consequence of the Canadian trade agreement, effective January 1, 1936, which lowered the duty on whisky, and 4 or more years, from 45 to \$2.50 per proof gallon. Revenue from dutiable imports, other than alcoholic beverages, is estimated to increase \$15,000,000 over the amount collected in 1935.

**Miscellaneous receipts.**—Total receipts from miscellaneous revenues and the realization upon assets are estimated at \$183,000,000, a decrease of \$76,000,000 from the estimate carried in the Budget Summary of September 30, 1935. This decrease is due to a downward revision of about \$100,000,000 in the estimate of repayment of investments, of which about \$70,000,000 represent a decrease in the amount expected to be paid by the Public Works Administration on its obligations held by the Treasury from moneys received as repayments of loans made to States, municipalities, and railroads. These receipts will be used by the Public Works Administration as a revolving fund from which additional loans may be made. The decrease of \$100,000,000 is partly offset by an upward revision of \$24,000,000 in the receipts from various sources of miscellaneous revenue.

#### REVENUE ESTIMATES FOR THE FISCAL YEAR 1937

Total receipts from customs and internal revenue, exclusive of agricultural adjustment taxes, taxes upon carriers and their employees, the bituminous coal tax, and the social security taxes, for the fiscal year 1937, are estimated at \$4,400,000,000, an increase of approximately \$740,000,000 over the estimate for the fiscal year 1936. The estimated increase reflects expected further business improvement in the calendar year 1936 and the fiscal year 1937 and, in part, the effects of the Revenue Act of 1935.

**Income taxes.**—Collections from current corporate income taxes are estimated at \$627,000,000, an increase of \$212,000,000 over the estimated amount for 1936. Of this increase, \$42,000,000 is expected to result from changes under the Revenue Act of 1935. The major provisions of that Act affecting corporate income taxes are: The substitution of a graduated tax (except in the

case of railroad corporations which continue having the privilege of filing consolidated returns), ranging from 12½ percent on net income not in excess of \$2,000 to 15 percent on net income in excess of \$40,000 for the single rate of 14½ percent imposed by the Revenue Act of 1934; the allowance of only 90 percent of dividends received from domestic corporations as a deduction from gross income; and an increase in rates of tax on personal holding companies.

Individual income taxes are estimated to yield \$236,000,000 or an increase of \$307,000,000 over the estimated collections for the fiscal year 1936. The increase in surtax rates on surtax net income in excess of \$50,000 incorporated in the Revenue Act of 1935 is expected to provide \$62,000,000 of this increase. Revenue from back taxes is estimated at \$180,000,000 or \$10,000,000 less than the estimate for 1936.

**Miscellaneous internal revenue.**—Collections from the taxes on capital stock, excess profits, estates, and gifts are estimated in the amount of \$461,000,000, or \$108,000,000 more than the estimate for the preceding fiscal year. This increase is the result of estimated increases in collections of \$66,000,000 in the capital stock tax and the excess-profits tax and of \$77,000,000 in the estate tax, which together are considerably greater than the estimated decline of \$35,000,000 in collections from the gift tax.

The increases in the capital stock and excess profits taxes are entirely due to the Revenue Act of 1935. Under that Act the rate of tax on capital stock was increased from 8½ to 11.40 per \$1,000 of the adjusted declared value. The rate of tax on excess profits was changed from 5 percent under the Revenue Act of 1934 upon net income in excess of 6 percent of the adjusted declared value of capital stock to 6 percent of net income in excess of 10 percent and not in excess of 15 percent of adjusted declared value, and 12 percent on net income in excess of 15 percent of adjusted declared value. In consequence of the changes in excess profits tax provisions, corporations are expected to declare a higher capital stock valuation than under the 1934 act. The increase in the capital stock valuation and the higher rate of tax form the basis for the estimated increase in revenue.

The estimated increase in the estate tax reflects estimated higher values of estates and, in part, the provisions of the Revenue Act of 1935, which lowered the specific exemption from \$50,000 to \$40,000 and increased the rates of tax. In the calendar years 1934 and 1935, large gifts were probably induced by expected increases in taxes on incomes and estates. In consequence, a large amount of revenue was received from the gift tax in the fiscal year 1935 and large collections are expected from this source in the fiscal year 1936. In the fiscal year 1937, revenues from the gift tax are expected to be of smaller amount, although the increased tax rates and reduction in the specific exemption from \$50,000 to \$40,000 under the Revenue Act of 1935 will be in effect.

Collections from taxes on distilled spirits, wine and fermented liquors, tobacco products, documentary stamps, manufacturers' excise taxes and miscellaneous taxes are estimated to increase \$138,000,000 in consequence of expected further business improvement.

The following table shows estimated collections from the principal sources of miscellaneous internal revenue for the fiscal years 1936 and 1937.



TABLE No. 1—Continued

Estimates of appropriations for the fiscal year 1937 compared with appropriations for the fiscal years 1930 and 1933 and estimated receipts and expenditures for the fiscal years 1937 and 1936 compared with actual receipts and expenditures for 1935—Continued

## A. GENERAL AND SPECIAL ACCOUNTS—Continued

ESTIMATES, APPROPRIATIONS, AND EXPENDITURES—Continued	Estimate of appropriations, 1937	Appropriations, 1936	Appropriations, 1935	RECEIPTS—EXPENDITURES		
				Estimate, 1937	Estimated, 1936	Actual, 1935
<b>GENERAL—Continued</b>						
<i>Trust charges—Continued.</i>						
Department of Commerce						
Insurance of bonds, etc., Public Works Administration	\$10,000 00	\$1,000,000 00		600,000	4,000,000	
Interest from foreign governments under debt settlements	20,000 00	20,000 00	23,000 00	20,000	20,000	813,230 00
Interest from loans, foretakers, etc., etc.	800,000,000 00	742,000,000 00	828,514,000 00	760,000,000	747,000,000	800,000,000 00
<i>Patents</i>						
Customs	18,000,000 00	14,000,000 00	11,500,000 00	17,000,000	18,000,000	20,712,000 00
General revenue	8,000,000 00	25,000,700 00	41,000,000 00	32,000,700	33,000,000	33,000,000 00
Provision tax on fish products				62,000,000	20,000,000	20,000,000 00
Total, general	5,947,000,000 00	4,200,000,700 00	4,860,524,000 00	4,960,000,700	4,720,707,100	4,710,000,000 00
<i>Recovery and relief—Continued.</i>						
Reconstruction Finance Administration			\$200,000,000 00	20,000,000	70,000,000	100,000,000 00
Community Credit Corporation				-101,245,300	144,000,000	100,000,000 00
Reconstruction Finance Corporation funds				+4,000,000	7,000,000	100,000 00
Other						
Farm Credit Administration						
Reconstruction Finance Corporation funds				+311,000	-403,000	4,000,000 00
Crop production loans						
Regional agricultural credit operations				+14,528,000	+26,018,000	6,000,000 00
Loans to joint-stock farm banks				+30,000	+100,000	9,000,000 00
Farm mortgage relief						111,000 00
Federal Farm Mortgage Corporation						15,000,000 00
Federal intermediate credit banks (excluding fund)						100,000 00
Farm Credit Administration						115,607,170 00
Other				+6,000,000	+23,000,000	
Federal land banks						1,000,000 00
Capital stock						30,000,000 00
Subsidy loans to land-in-burden	20,000,000 00	20,000,000 00	75,000,000 00	41,000,000	33,000,000	30,000,000 00
Refundation in interest rate on mortgages	20,000,000 00	20,000,000 00	7,500,000 00	23,000,000	20,000,000	12,077,070 00
<i>Relief</i>						
Federal Emergency Relief Administration, including Burdick Relief Corporation						400,000 00
Other						828,000,000
Civil Works Administration						11,007,207 00
Emergency Conservation Work						800,000,000 00
Department of Agriculture, relief						4,200,000 00
<i>Public Works</i>						
Boulder Canyon project				6,000,000	15,750,000	20,430,000 00
Bonds and grants to State, territorial, or local governments				230,730,000	27,400,000	227,200,000 00
Public highways				112,000,000 00	200,214,000	275,543,000 00
River and harbor work				84,212,000	182,510,000	147,524,250 00
Civil Electrification Administration				2,000,000	4,000,000	10,000 00
Works Program Administration						1,000,000,000
Other public works						
Administrative expenses, Public Works Administration				15,000,000	20,000,000	15,000,000 00
Legislative and witnesses				1,707,000	2,000,000	2,000,000 00
State Department						2,400,000 00
Treasury Department						
Public buildings				65,000,000 00	40,000,000	62,700,000 00
Other				4,752,000	26,000,000	4,115,000 00
War Department (military)						1,400,000 00
National Defense						
Army				4,800,000	21,000,000	11,200,000 00
Navy				41,200,000	230,200,000	202,000,000 00
Postoffice and Marine						700,000 00
Department of Justice						501,700 00

\* Excess of credits, deficit.

† The expenditure shown here to emergency are included in the regular expenditures in the General Budget Summary and Supporting Schedule No. 2. Includes \$100,000,000 advance for costs appropriated under Treasury Department.

TABLE No. 1—Continued

Estimate of appropriations for the fiscal year 1937 compared with appropriations for the fiscal years 1930 and 1933 and estimated receipts and expenditures for the fiscal years 1937 and 1936 compared with actual receipts and expenditures for 1935—Continued

## A. GENERAL AND SPECIAL ACCOUNTS—Continued

ESTIMATES, APPROPRIATIONS, AND EXPENDITURES—Continued	Estimate of appropriations, 1937	Appropriations, 1936	Appropriations, 1935	RECEIPTS—EXPENDITURES		
				Estimated, 1937	Estimated, 1936	Actual, 1935
<b>GENERAL—Continued</b>						
<i>Recovery and relief—Continued.</i>						
Public Works—Continued						
Other public works—Continued						
Department of the Interior					20,000,000 00	107,800,100
Department of Agriculture						271,420,000
Department of Commerce						400,000,000 00
Department of Labor						4,700,000 00
Veterans' Administration						1,910,000 00
Independent offices and commissions						4,000,000 00
District of Columbia						10,000,000 00
Unclassified items						150,710 00
All in loans except						
Broadcast system						
Reconstruction Finance Corporation funds						60,000,000 00
Home loan relief stock						44,000,000 00
Home Owners' Loan Corporation						20,000,000 00
Federal savings and loan associations						4,000,000 00
Emergency Housing Administration						61,000,000 00
Federal Housing Administration						40,000,000 00
Reconstruction Finance Corporation funds						14,000,000 00
Other						872,810 00
Reclamation Administration						73,200,000 00
Reclamation Administration						300,000 00
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Reclamation Administration						73,200,000 00
Reclamation Administration						300,000 00
Reclamation Administration						100,000,000 00
Reclamation Administration						73,200,000 00
Reclamation Administration						

TABLE No. 1—Continued

Estimates of appropriations for the fiscal year 1937 compared with appropriations for the fiscal years 1936 and 1935 and estimated receipts and expenditures for the fiscal years 1937 and 1936 compared with actual receipts and expenditures for 1935—Continued

## B. TRUST ACCOUNTS

	Estimates of appropriations, 1937	Appropriations, 1936	Appropriations, 1935	RECEIPTS—EXPENDITURES		
				Estimated, 1937	Estimated, 1936	Actual, 1935
<b>RECEIPTS</b>						
District of Columbia, receipts.....				\$35,327,000	\$38,713,685	\$47,987,000.00
Government life-insurance fund.....				70,601,145	70,518,483	66,531,574.00
Adjusted-service certificate fund.....				9,100,000	7,125,000	5,781,188.00
Civil-service retirement and disability fund.....				42,000,000	42,000,000	40,729,611.75
Foreign Service retirement and disability fund.....				313,000	297,000	284,135.00
Canal Zone retirement and disability fund.....				552,000	552,000	549,260.75
Deposits by States under Social Security Act.....				282,800,000	48,500,000	
Indian money, Department of the Interior.....				7,859,900	6,859,900	6,680,888.50
Insular possessions:						
Processing tax.....				21,121,000	21,122,400	12,540,824.25
Others.....				17,000,000	17,025,000	16,450,363.14
Miscellaneous trust accounts.....				33,175,740	33,221,971	31,811,668.25
Unclassified items.....						* 2,628,582.50
<b>Total.....</b>				<b>520,350,685</b>	<b>290,435,409</b>	<b>229,600,234.25</b>
<b>EXPENDITURES</b>						
District of Columbia.....	\$37,400,000.00	\$36,514,115.00	\$32,681,542.58	37,982,472	44,582,215	42,810,901.87
Government life-insurance fund.....	70,601,145.00	67,600,000.00	68,040,000.00	70,601,000	70,518,500	68,680,000.44
Adjusted-service certificate fund.....				8,500,000	6,500,000	6,525,001.50
Civil-service retirement and disability fund.....				48,000,000	41,200,000	40,784,269.25
Foreign Service retirement and disability fund.....				460,000	450,000	301,888.50
Canal Zone retirement and disability fund.....				585,000	580,000	574,000.25
Social Security Act.....				282,800,000	48,500,000	
Indian moneys, Department of the Interior.....	4,715,000.00	4,280,000.00	3,785,000.00	7,600,000	12,475,000	1,294,669.50
Miscellaneous trust accounts.....	37,470,338.00	37,921,650.00	6,563,740.00	30,812,982	57,071,715	4,665,534.34
Unclassified items.....						304,227.87
<b>Total.....</b>	<b>150,186,483.00</b>	<b>146,215,765.00</b>	<b>111,050,282.58</b>	<b>507,301,454</b>	<b>281,677,439</b>	<b>165,959,662.87</b>
Excess of receipts over expenditures.....				13,049,231	4,557,970	63,700,571.68

\* Counter entry receipts, deduct.

[UNREVISED PRINT]

**REVENUE ACT, 1936****HEARINGS**

BEFORE THE

**COMMITTEE ON FINANCE****UNITED STATES SENATE****SEVENTY-FOURTH CONGRESS****SECOND SESSION**

ON

**H. R. 12395****AN ACT TO PROVIDE REVENUE, EQUALIZE TAXATION  
AND FOR OTHER PURPOSES****PART 1**

APRIL 30, 1936

*M. Helms* — *M. Van*  
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UNREVISED PRINT  
REVENUE ACT, 1938

HEARINGS  
COMMITTEE ON FINANCE  
UNITED STATES SENATE

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## REVENUE ACT, 1936

THURSDAY, APRIL 30, 1936

UNITED STATES SENATE,  
COMMITTEE ON FINANCE,  
Washington, D. C.

The committee met, pursuant to call, at 10 a. m., Senate Finance Committee room, Senate Office Building, Senator Pat Harrison presiding.

Present: Senators Harrison (chairman), King, George, Walsh, Barkley, Connally, Bailey, Clark, Black, Gerry, Guffey, Couzens, Keyes, La Follette, Metcalf, Hastings, and Capper.

The CHAIRMAN. The committee will come to order. Mr. Secretary, we will begin at these public hearings our consideration of this bill that was passed yesterday by an overwhelming vote in the House, and we would like you to make a statement, and say to the committee whatever you desire.

### STATEMENT OF HON. HENRY MORGENTHAU, JR., SECRETARY OF THE TREASURY

Mr. MORGENTHAU. Mr. Chairman: I welcome the opportunity to appear and discuss with you the tax proposals contained in the President's message to the Congress of March 3, and to present the Treasury's viewpoint.

As Secretary of the Treasury, I feel a special responsibility to do all in my power to maintain the integrity of the President's Budget of January 3, 1936; and therefore to urge that the supplemental revenues made necessary by the developments of the past few months be provided.

The Treasury has been able to borrow readily the amounts necessary to finance the recovery program and has been able to obtain these loans at steadily decreasing interest rates. The continuance of this satisfactory situation, however, will depend upon scrupulous adherence to an orderly program looking to a balance of the Federal Budget just as soon as the needs and abilities of our people make that possible and therefore upon a steady reduction in the public debt.

In his Budget message of January 3, 1936, the President made this statement:

"If the Congress enacts legislation at the coming session which will impose additional charges upon the Treasury, for which provision is not already made in this Budget, I strongly urge that additional taxes be provided to cover such charges. It is important as we emerge from the depression that no new activities be added to the Govern-

ment unless provision is made for additional revenue to meet their cost."

At another point in the same message the President said:

"It is pertinent to repeat here a statement appearing in the Summation of the 1936 Budget: 'Estimates of receipts contemplate continued collection of processing taxes. If the attack which has been made upon this act is sustained, we will have to face the problem of financing existing contracts for benefit payments out of some form of new taxes.'"

On the very day that the President's Budget message was read to the Congress the Supreme Court of the United States rendered a decision holding the Agricultural Adjustment Act unconstitutional. Since that date the Congress has enacted, over the President's veto, the Adjusted Compensation Payment Act of 1936, which requires payment, beginning on June 15, of the entire amounts, which were to be due in 1945 and thereafter, on the veterans' adjusted-service certificates. The additional cost of making those payments this year, when distributed over the next 9 years, comes to approximately \$120,000,000 a year. The Congress has provided for carrying on a continuing program of conservation of the Nation's agricultural resources which will result in expenditures of approximately \$500,000,000 a year.

Thus to conform to the Government's financial program, as set forth in the President's Budget message, we shall need to provide additional continuing revenue of \$620,000,000 annually to meet those expenditures. We shall also have to find means of recouping approximately \$517,000,000 of revenue sacrificed in the current fiscal year because of the invalidation of the Agricultural Adjustment Act.

The President in outlining those needs suggested three sources of revenue which could be made available for the purpose. One of those suggestions was for processing taxes on agricultural products at lower rates and distributed over a broader base than the similar taxes under the Agricultural Adjustment Act. Another was for a special form of income tax, described as a "windfall" tax, on the unjust enrichment accruing to some corporations and individuals as a result of their escape from the payment of processing taxes. The amount of the processing taxes due prior to January 6 which had thus escaped was approximately \$237,000,000.

The third program, and the one of major importance, was for a revision of our system of corporation taxes. It was proposed by the President that the three existing forms of corporate taxes be repealed. Those include the capital-stock tax, the excess-profits tax, and the corporation income tax. The President proposed that there be substituted for those taxes a tax upon that portion of corporation income which is not currently distributed to stockholders in dividends and that at the same time the present exemption from the normal income tax of four percent of dividends received by individuals from corporations be repealed.

The status of the President's proposals today is that the House has passed a bill to give effect to two of them. The House bill is estimated by the Treasury to yield additional revenue as follows: (a) Net continuing revenue of \$623,000,000 yearly from a tax on corporate earnings, and (b) net temporary revenue of \$180,000,000

from an unjust enrichment tax and temporary extension of the capital-stock tax, divided as follows—

Senator BARKLEY. Right there, if I may interrupt you, Mr. Secretary. Your sentence may not be exactly accurate. The net income revenue of \$623,000,000—you mean an additional net income over and above what is now being received?

Mr. MORGENTHAU. Yes, sir.

Senator BARKLEY. So that that might be corrected there?

Mr. MORGENTHAU. Thank you. To continue: From the unjust enrichment tax, \$100,000,000; from the extension of the capital stock tax for 1 year at one-half of the present rate, \$80,000,000.

The bill thus fully provides the \$620,000,000 needed to take care of the permanent agricultural program and the annual financing of the payment of the soldiers' bonus. It also provides for the first year of a 3-year program for recouping the loss of \$517,000,000 of processing taxes lost during the fiscal year 1936. However, it does not provide any temporary revenues for the two succeeding years to make up the balance of \$337,000,000 of temporary revenues desired.

The estimated yield of \$623,000,000 from the tax on corporate earnings is the amount of additional revenue to be derived from the application of the rates and schedules in the House bill to corporate income for the present calendar year, 1936. It must be recognized that the choice of an income tax as the means for raising additional revenue necessarily involves a delay in realization of increased receipts. Receipts from taxes on corporate incomes for the calendar year 1936 will be collected in the main during the calendar year 1937 and will be divided between the two fiscal years, the fiscal year 1937, ending June 30, 1937, and the fiscal year 1938. The net additional revenue to be expected from the application of the corporate income tax is estimated to be \$310,000,000 in the fiscal year 1937. The full additional annual revenue would be collected in the fiscal year 1938.

Senator KING. Do I understand you, Mr. Secretary, that next year, 1937, for the calendar year this tax will only bring in three hundred and some odd million?

Mr. MORGENTHAU. Between January 1, 1937, and June 30, 1937, this tax will produce \$310,000,000.

The House bill follows the President's suggestions in providing for the repeal of the corporation income tax, the capital stock tax, and the excess profits tax and by making dividends received by individuals subject to the normal tax of 4 percent. In place of the repealed taxes it substitutes a new form of tax on corporate income with rates based on the percentage retained by the corporation. The estimated annual yield of \$623,000,000 is the amount by which it is expected taxes paid by corporations and individuals under the proposed plan will exceed the yield of corporate and individual taxes under the present law. That covers that point.

It is to be noted that the bill as passed by the House of Representatives, while failing, according to our estimates, to raise temporary revenues for a 3-year period in the full amount sought by the President, utilizes but two of his three suggestions. The third was for the enactment of processing taxes on a broader base but with lower rates than were in effect under the Agricultural Adjustment Act. I call this potential source of additional revenue to your attention again. I feel sure that the Department of Agriculture stands ready to supply any information you may desire on this subject.

Turning from the revenue aspects of the House bill, in which the Treasury is primarily interested, let us consider also the two suggestions made by the President, to which the House bill gives effect, from the standpoint of equity in our tax system.

As to the proposed unjust enrichment tax, I think there is little that need be said. I have not heard the justice of this tax very seriously questioned. There is no doubt whatever that the avoidance of payment of processing taxes accrued prior to January 6 has resulted in unjust gains to a limited number of persons and corporations. It would be grossly unfair to the persons and corporations who paid their processing taxes as due up to the time of the Supreme Court's decision and it would be unfair to the American consumer, who ultimately bore the major burden of the taxes, not to reduce this unjust enrichment as much as we can by taxation.

I take it for granted that an unjust enrichment or "windfall" tax will be enacted by the Congress. I assume, too, that you will give most serious consideration to the matter of the deficiency in the temporary revenue for a 3-year period expected from the House bill as compared with the President's estimates of the need. I turn, therefore, to the proposed tax on corporate income.

The principle of taxation according to ability to pay is now well established, not merely by having been written by amendment into the Constitution of the United States and supported by 20 years of application in our tax structure, but by the undoubted and unquestioned endorsement and support of the citizens of this Nation. Through successive changes in our tax laws, however, we have departed most seriously from a consistent and just application of the principle. Under the existing law we apply the principle to individual incomes, whether they are obtained from interest, rents, or salaries, from the profits of individual business enterprise or from partnership undertakings. We do not apply it to profits gained from corporate enterprise, except in a manner which taxes some citizens at unfairly high rates and gives to others the opportunity to avoid taxation on a wholesale scale.

Where a corporation makes approximately full distribution of its current earnings, the stockholder under present law first bears the burden of three different corporation taxes—the capital stock tax, the excess-profits tax, and the corporate income tax; second, he is required to pay surtaxes on the dividends paid to him. This stockholder thus pays what is in effect a normal tax of about 15 or 16 percent as compared to a normal tax of 4 percent paid by the individual who derives his income from other sources. On the other hand, the present law permits stockholders of large incomes to avoid the payment of surtaxes which may run to rates as high as 75 percent on their share of corporate earnings which are not distributed as dividends.

What are the dimensions of tax avoidance with which we are dealing? A few simple figures tell the story. It has been estimated by the Treasury Department that under the present tax law the income tax liability of corporations on the basis of 1936 earnings would approximate 964 millions. The Department has also estimated that under the present law more than 4½ billion dollars of corporation income in the calendar year 1936 will be withheld from stockholders and that if this income were fully distributed to the individual owners of the stock represented in those corporations, the resultant yield in additional individual income taxes would be about \$1,300,000,000.

With tax avoidance occurring on the scale indicated by the figures I have cited, I do not see how any increase in individual income tax rates or other general and continuing taxation could be justified until this leak in our tax system is stopped.

Whatever may be the debatable considerations that may enter into the preparation of particular schedules, it will be well to bear in mind at all times that this is purely and simply a proposal to put all taxes on business profits essentially on the same equitable basis; to give no advantages and to impose no penalties upon corporation stockholders that are not given to and imposed upon the individual taxpayer who alone or as a partner derives his income from business profits.

In closing let me say this: I sincerely hope that this committee will report to the Senate a bill giving effect, as fully as possible, to the President's recommendations of the amount of additional revenue needed to supply the deficiencies created since the Budget message of January 3.

The CHAIRMAN. Mr. Secretary, in title IV of the House bill, it provides for refunds of certain processing taxes. Were these taken into consideration and into account in the estimate of \$517,000,000 of temporary revenues needed?

MR. MORGENTHAU. No; they were not, if I may, I have a short explanation.

They were not taken into consideration because it was impossible for us to determine at that time all the possible liabilities that might occur as the result of the invalidation of the Triple-A Act. All of these questions are not yet settled. For instance, we may still have to consider other claims for refunds arising under section 21d of the amendment to the Agricultural Adjustment Act passed at the last session. But the Ways and Means Committee, which inserted the refund provisions in the present bill, regards these particular refunds as fulfilling a moral obligation of the Government, and I agree. We estimate that they will amount to \$43,000,000. If we add this to the \$517,000,000 the amount to be raised in 3 years is \$560,000,000, and if we deduct the \$180,000,000 of temporary revenue in the House bill the remainder to be raised for the following 2 years is \$380,000,000, or \$190,000,000 for each of the 2 years.

The CHAIRMAN. Are there any questions of the Secretary?

Senator KING. Mr. Secretary, in determining the amount required, did you take into consideration the large appropriations which will perhaps be \$1,200,000,000 for the Army and the Navy for the next year, and approximately \$1,000,000,000 for flood relief and rivers and harbors?

MR. MORGENTHAU. Senator King—

Senator KING (interposing). Pardon me. And \$1,500,000,000 or possibly \$2,000,000,000 for relief to be expended by Mr. Hopkins or by Mr. Ickes, or both?

MR. MORGENTHAU. Well, to answer your question, the Budget picture as it is today—whatever time it is—is just where it was approximately, and it may be a little bit off—but approximately as when it was sent up by the President to Congress, with two exceptions. One is due to the decision of the courts on the A. A. A., and the other is due to the soldiers' bonus.

When the President sent up his message, he forecast a deficit for the coming fiscal year of \$1,098,000,000, and he pointed out that if

the Congress would appropriate up to \$2,136,000,000 for relief, that the deficit for the coming year would not be in excess of the deficit for the previous year. He did ask for \$1,500,000,000, so if you take \$1,098,000,000—let us call it a billion and one—plus the billion and a half, you get the approximate picture for the next year.

But I would like to give you the exact figures. I have it prepared to give you, if I may.

The Budget deficit for 1936 was \$3,234,500,000 on January 3. That is the way the President forecast it. To this you have to add the \$495,100,000, and you get the figure of \$3,729,600,000. For purposes as near as anybody can estimate, to this year's deficit we add the total of the veterans' bonus which goes out on June 15. We always take the top figure in the Treasury; we have to. We have to assume it is all going to go out. If it all goes out, we add \$2,237,000,000, or total estimated deficit for 1936 of \$5,966,600,000. That is the way it stands.

For the fiscal year 1937, the President's estimated deficit of \$1,098,000,000, he asked for \$1,500,000,000, which gives you \$2,598,000,000.

You have to adjust expenditures due to the A. A. A. on account of the Court's decision, you have to add \$524,000,000, from which you deduct \$400,000,000, which is the increased estimates in the present bill; so you get from that \$34,000,000. Then we have the \$43,000,000 which we have just talked about, an increase for next year which has not been accounted for, of \$77,000,000, or to bring an estimated deficit for 1937 to \$2,675,000,000.

To read that again—putting the bonus in, making adjustment for the A. A. A. which is the only difference, adding \$1,500,000,000 for relief, we forecast for this year a deficit of \$5,966,000,000, and for the next year, \$2,675,000,000.

To refresh your memory, the gross deficit in 1934 was \$3,989,000,000; for 1935 \$3,575,000,000; the estimate for this year of \$5,966,000,000, and 1937 \$2,675,000,000.

So that if it were not for the soldiers' bonus, 1934, 1935, 1936, and 1937 each year we would have a declining deficit.

Senator BARKLEY. Of course, that estimated deficit for 1937 will be reduced by whatever amount the ex-service men decline to accept in cash and continue to carry their bonds.

Mr. MORGENTHAU. That is perfectly true, Senator, but of course—

Senator BARKLEY (interposing). I realize that in making your estimates, you have to take into account the possibility of all of them cashing them.

Mr. MORGENTHAU. The top figure.

Senator BARKLEY. But we all know that that will not be the figure that will actually be necessary.

Mr. MORGENTHAU. That is true.

Senator BARKLEY. But for bookkeeping purposes, you have to assume it.

Mr. MORGENTHAU. For good, sound financing purposes, we would rather play safe.

The CHAIRMAN. As a matter of fact, if it had not been for the Court's decision and the passing of the Adjusted Compensation Certificate legislation, we would not have been called upon to pass a tax bill at this session of Congress.

Mr. MORGENTHAU. That is true.

Senator KING. But you would still have a deficit?

Mr. MORGENTHAU. Yes, sir; and the President pointed out exactly what the deficits are, and I may say that his estimates for receipts had been running within 1 percent of what he estimated, and his expenditures have constantly run under his estimates.

Senator HASTINGS. Mr. Secretary, if what the chairman says is true, and you agree that it is true, that there would have been no necessity for any tax bill at all except for the Supreme Court's decision upon the A. A. A., why did you not content yourself with raising sufficient money to pay that debt and quit there? That obligation?

Mr. MORGENTHAU. I do not quite understand, Senator.

Senator HASTINGS. I understand you to say that it would not have been necessary to have had a tax bill except for the Supreme Court's decision declaring the A. A. A. void.

Senator BARKLEY. And the bonus.

The CHAIRMAN. I added to it "and the bonus."

Senator HASTINGS. I understood the chairman to say that if it had not been for the Supreme Court's decision, there would have been no tax bill necessary, and I understood you to agree to it. Now, I understand that is not so.

The CHAIRMAN. I stated, the Supreme Court's action, together with the passage of the act for adjusted-service certificates.

Senator HASTINGS. I did not so understand it.

Mr. MORGENTHAU. The President is on record to that effect; that he would ask for no new taxes.

Senator HASTINGS. I did not understand it.

Mr. MORGENTHAU. I would like to point out that the President is on record that he would have asked for no new taxes this year unless the Congress passed legislation which was not included.

Senator HASTINGS. He was also on record last year, as I recall it.

Mr. MORGENTHAU. If he was, he kept his word.

Senator HASTINGS. He did ask for taxes last year.

Mr. MORGENTHAU. There is nothing stated in his Budget message of the year previous, as far as I know.

Senator HASTINGS. Not in his Budget message, but in his Message to the Congress in 1935, you will find a statement to the effect that he was not anticipating asking the Congress to add any new taxes to the present rate.

Mr. MORGENTHAU. If you do not mind, I would like to refresh my memory on that.

Senator HASTINGS. I think you will find I am correct.

Mr. MORGENTHAU. Because as far as I know, every statement that the President has made on his Budget in fiscal matters, he has absolutely kept his word.

Senator COUZENS. I ask you, Mr. Secretary, have you made any estimates of what the increased revenue would be due to increased business, if the taxes were to remain in status quo?

Mr. MORGENTHAU. Senator Couzens, we cannot forecast beyond the fiscal year of 1937. We have been rash enough each year to do that, and as I say, we have come within 1 percent, but the forecast beyond 1937 would really be taking too much upon us.

Senator COUZENS. Well, assume that we only consider the calendar year 1936, have you any estimates about the increased revenue, what

the increased revenue would be on the present law due to increased business?

Mr. MORGENTHAU. That is included. Our forecast for both the calendar year 1936 and the fiscal year 1936—we are operating on that now, and our estimates show that our revenue to date for both the fiscal and the calendar year are running about 1 percent in excess of our estimates.

Senator COUZENS. What were they? Do you remember?

Senator LA FOLLETTE. In other words, if I understand you, Mr. Secretary, when you made the estimates, you took into account as a factor, whatever the actuaries decided to allow for improved business conditions?

Mr. MORGENTHAU. We did, and as I say, I am rather proud of the work of the technical men in that respect, because the estimates are running just about 1 percent in excess when we have taken into account a healthy increase in business for this year.

The CHAIRMAN. Do you recall in recent history where any Secretary of the Treasury has come so close to the estimates and revenues as was done last year?

Mr. MORGENTHAU. No; and here is the record if you would like it.

The CHAIRMAN. It is my opinion that no one has come so close. Will you agree with my statement on that?

Mr. MORGENTHAU. Yes; I will; I am glad to agree to it.

As a matter of fact, in 1931, they missed the estimates by 15 percent. In 1932, they missed it by 7 percent. In 1933 they missed it by 13 percent. In 1934, they missed it by 5 percent.

The first forecast, for 1935, which I made, the revenue is 4.6 percent over what we estimated; and this year—again I am responsible—we are running about 1 percent in excess of our revenues.

Senator KING. The chairman wants you to state that the Democrats are better prophets than the Republicans.

The CHAIRMAN. I do not want to get any partisanship into this discussion.

[Laughter.]

Senator HASTINGS. Mr. Secretary, will you go over those again and see whether they were underestimated or overestimated?

Mr. MORGENTHAU. I will be very glad to, Senator Hastings. This sheet that I have here says, "Comparison of actual and estimated income tax receipts, fiscal year 1931 to 1936, inclusive, daily Treasury statement basis."

In 1931, whoever was Secretary of the Treasury, estimated—

Senator BLACK. Who was that; do you recall?

Mr. MORGENTHAU. I guess it must have been Mr. Mellon.

[Laughter.]

The then Secretary of the Treasury estimated receipts of \$2,190,000,000, and the actual receipt of \$1,860,000,000, or 15.1 percent less than the estimate.

Senator HASTINGS. Is that true all the way down?

Mr. MORGENTHAU. I will be glad to continue.

Senator HASTINGS. Just answer my question.

Mr. MORGENTHAU. It runs from 15 percent to 5 percent off.

Senator HASTINGS. And they were less?

Mr. MORGENTHAU. They always were less. And in 1935, which is the first year that I had a chance to forecast, our revenues exceeded

4.6 percent, and this year we are running about 1 percent. I mean, after I came in in the fall of 1933, and I am responsible for 1935 and 1936 calendar years; in those 2 years, they were the first 2 years, going back to 1931, that the revenue has exceeded the estimates.

Senator HASTINGS. I am glad this administration was correct in some estimates.

Mr. MORGENTHAU. Well, sir, they have been correct on all of their estimates.

Senator HASTINGS. Including balancing the Budget?

Mr. MORGENTHAU. We have done everything on a fiscal financial basis that we have said. As I pointed out before, Senator Hastings, our revenue estimates have exceeded, and our estimates for expenditures every year have been under.

Senator KING. May I say that I hope that my friend from Delaware will not blame the President for the eccentricities of Congress.

Senator HASTINGS. I won't blame him for anything.

The CHAIRMAN. You may have forgotten, Mr. Secretary, but some of us recall that when Mr. Mills was Secretary of the Treasury, he revised his estimates three times in 6 months, and then he was wrong in a greater amount than you.

If that is all, thank you very much, Mr. Secretary.

Senator COUZENS. I would like to ask the Secretary a few questions. It appears that the gift tax was estimated in 1936 as \$60,000,000, and the actual collection up to date was \$154,751,457. I am wondering to what extent if at all you contemplate that that will affect the high surtax brackets.

Mr. MORGENTHAU. Mr. McLeod will answer that. If you will, please?

Mr. McLEOD. We have considered that in our estimate. We have made adjustments for that in our estimates by reason of the smaller number of individuals in the high surtax brackets, as closely as we could, meaning that there has been a shift downward to some extent from the high surtax brackets to the lower.

Senator COUZENS. But you do not recall the amount in dollars and cents?

Mr. LEOD. No; I do not have that.

The CHAIRMAN. Are there any other questions?

(No response.)

(The Secretary retires.)

The CHAIRMAN. Before we proceed. The Secretary has gone, has he not?

Mr. HELVERING. Yes, sir; he has.

The CHAIRMAN. I wanted to make this request at this time. I was going to request him, and so I request through his experts, that the Secretary do this. It seems to some of us—I was conferring with Senator La Follette, and I know that he and I are of this opinion—this House bill is rather complicated. I think they have done a magnificent job, but in order to get at the same results on the amount of taxes to be raised through this change in policy of assessing the stockholder instead of the corporation, if you could not work out some plan that would simplify the matter, and instead of having four columns as are included in this bill, if you could not get it down to one column, so that the layman might work out the proposition.

I can appreciate that it had to be written, probably, this way, because you have your instructions from the Ways and Means Committee, and I offer no criticism; but if we can work out a simplified form, it would be much better; and I understood that over there it was their desire to give some relief to the smaller corporations, more than to the larger corporations, and that is why the bracket was fixed under \$10,000 adjusted net income and over \$10,000 adjusted net income.

It will be recalled that in some of the prior bills that we have passed, in order to help the smaller corporations we exempted \$1,000 and \$2,000 and \$3,000. I think we got up that far. Now, it would seem to some of us that if you had one column and could work it out by exempting, say, up to \$25,000 adjusted net income, or \$1,000, or maybe \$2,000, that we would get the same results that the House was trying to get at and that it would simplify the scheme.

So that what I was going to ask the Secretary, and I request it of you gentlemen, is to work out your estimates to see whether or not that can be done and submit it to the committee, and to give us an estimate on the proposition of putting up to \$20,000, and then up to \$25,000, adjusted net income, and to give off \$1,000, and to exempt \$2,000. Make it on those two bases, to see whether or not we might get the same results in revenue as are obtained by the bill.

If you can do that, you will greatly simplify this matter.

Senator LA FOLLETTE. And, Mr. Chairman, may I ask for one further thing to be considered? I am entirely in sympathy with what the chairman has said about simplifying the bill. Another thing I would like to have worked out to be submitted for the consideration of the committee is to work out a schedule putting the tax on the amount retained instead of having to have the schedule 2A, with the interpolator, which so much fun has been poked at. As I understand it, schedules can be worked out which will result in exactly or approximately the same amount of tax being paid; but if they are worked out in percentages on the retention of earnings, we can get rid of this interpolator and make the tax readily understandable to anybody that reads it. I would like to have that submitted also, just for the consideration of the committee.

The CHAIRMAN. In that connection, may I ask you, Mr. Commissioner, if the fact that the House, the last day when they had the bill up for consideration, under the 5-minute rule, amended the law so as to make the dividends payable in the taxable year, instead of as originally drawn, did not eliminate one difficulty to enable you to do just what Senator La Follette has requested you to do, and to work it out on the retained surplus instead of what is paid out.

Now, you may proceed, Mr. Helvering.

#### STATEMENT OF GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, TREASURY DEPARTMENT

Mr. HELVERING. I have a short statement.

The Secretary of the Treasury has just presented to you an analysis of the additional revenue needs of the Federal Government, as outlined in the President's supplementary Budget message of March 3, and the extent to which those needs are met by the bill passed by the House of Representatives. Having appeared before the Ways and

Means Committee, I am glad to place myself at the disposal of this committee for any assistance I may render. As a preliminary I desire to make a few general statements as to the President's proposal and the House bill.

The first thing to which I should like to call your attention is the fact that in the last analysis none of the three sources of additional revenues suggested by the President involves new taxation. One of them—the "windfall" tax, so-called—is designed only to recoup, for the Treasury and the public, taxes that were actually paid by numerous business firms and by consumers generally, but which became part of private, rather than of the public, revenues. Another—the proposed tax on corporate earnings, coupled with the repeal of the existing corporate-income, capital-stock, and excess-profits taxes—is designed only to make effective the present schedules of income-tax rates applicable to individual incomes, by reducing the opportunities for tax avoidance and tax evasion. The third was for the enactment of processing taxes on a broader base, but with lower rates, than those that were in effect under the Agricultural Adjustment Act. The suggested processing taxes, therefore, would only replace the similar taxes previously in force and, moreover, are proposed for only a temporary period.

The CHAIRMAN. How much do you expect to get under the present regulation? About \$517,000,000 over a period of 3 years?

Mr. HELVERING. The schedules of the Agricultural Department presented to the Ways and Means Committee would raise approximately \$208,000,000 in a year.

Senator CLARK. By processing tax?

Mr. HELVERING. By processing tax; yes.

The CHAIRMAN. Which was not accepted by the committee?

Mr. HELVERING. No. I might say in that connection, that those were rates much lower. For instance, the wheat rate under the old schedule was 30 cents. Under the new proposal by the Agricultural Department it was 5 cents.

The CHAIRMAN. So they were greatly reduced as to the amount of processing tax?

Mr. HELVERING. About 20 percent average of the old rates.

The CHAIRMAN. And the base was broadened by taking in other commodities?

Senator KING. Upon which to impose the processing tax?

The CHAIRMAN. Yes. You may proceed, Mr. Commissioner.

Mr. HELVERING. The President's suggestion to obtain additional permanent revenue was for an improvement in our method of corporate income taxation. In essence, as I have already indicated, this proposal does not seek to impose any new taxes or any higher rates of taxes. On the contrary, its effect would be to lower taxes for a great many, perhaps the majority of our corporations in number; and to lower them also for a very large proportion of corporation stockholders.

Senator KING. I should like to make an inquiry. As a matter of fact, out of the three-hundred-and-some-odd-thousand corporations in the United States, less than half have ever paid any taxes at all; is that not true?

Mr. HELVERING. There are some 500,000 corporations in the United States, and the number that were in the small brackets—Mr. McLeod can tell you better.

Mr. McLEOD. In the small brackets, under the bill as proposed by the House, about 214,000 were under \$10,000; 43,000 had net incomes above \$10,000.

The CHAIRMAN. Mr. McLeod will be the next witness that will be before us, and he can go into that phase.

Mr. HELVERING. A great number of those corporations did not pay.

Senator KING. A majority of the corporations in the United States do not pay any taxes at all.

Mr. HELVERING. No; I do not think a majority. I think a majority of them do pay taxes, but quite a number of them in the small brackets.

The fundamental objective of this proposal is to increase the Federal revenues by plugging up a major source of tax avoidance and tax evasion now existing, and thereby greatly to increase the fairness and balance of the Federal income-tax structure as a whole.

Senator KING. Could you say that it is an avoidance or evasion if corporations have reserved what they regard as legitimate against days of adversity or to meet contingencies or for the purpose of expansion?

Mr. HELVERING. I did not mean to use these terms with any criminal intent on their part, but it is just a chance to do it, and do it legally, under the present law.

The President's proposal, the principles of which are incorporated in the House bill, is no new development. It has received the attention and support of students of taxation from the earliest days of income taxation in the United States. Its principles were incorporated in our first income-tax law, 1862-71, when Congress provided that the gains and profits of corporations should be included in the annual taxable gains, profit, or income of any person entitled to them, whether divided or undivided. Shortly before and while the Revenue Act of 1921 was under consideration, a proposal identical in principle with the President's suggestion received the support of many representatives of organized business, Members of Congress, and the Treasury Department. The principle was recommended by Secretary of the Treasury Houston in his annual report for the year 1920. In somewhat modified form, it was incorporated in a bill passed by the Senate in 1924.

The CHAIRMAN. Do you quote that part of Secretary Houston's report in your statement?

Mr. HELVERING. Do you wish it incorporated?

The CHAIRMAN. If you have not, I wish you would incorporate in your remarks that part of Secretary Houston's recommendation which deals with that phase.

Senator KING. And likewise that provision of the 1924 act which you think incorporates its principle; at any rate, if not in all respects, this provision is with respect to the taxation of undistributed profits.

Senator LA FOLLETTE. I did not understand the Commissioner to say that it became incorporated in a law. He said it passed the Senate in 1924.

Mr. HELVERING. Yes. It did not pass the Congress.

The CHAIRMAN. That is a good idea. Put it in that it passed the Senate. We had a great deal of respect for the Senate in 1924.

Mr. HELVERING. When corporations distribute their earnings to their stockholders, the dividends are subject to the surtax rates incorporated in our income-tax law. When corporate earnings are

not so distributed, the individual stockholders, while enjoying the benefit of those earnings in the form of the increased worth of their securities, are enabled to avoid all payment of surtaxes thereon.

Senator HASTINGS. Right there, Mr. Commissioner, How can he enjoy these earnings in the form of increased worth?

Mr. HELVERING. If they can be put in the reserve of the corporations, in the surplus, they therefore increase the value of the stock outstanding.

Senator HASTINGS. You say "while enjoying the benefit of those earnings in the form of the increased worth of their securities." The increased worth of the securities is of no particular good to them unless they sell them and realize on them.

Mr. HELVERING. No.

Senator HASTINGS. Then he pays the tax, does he not?

Mr. HELVERING. Oh, yes.

Senator KING. It seems to me, if I may be pardoned, Senator, that it is an advantage to have your securities increasing in value from year to year, though you do not have the increased value distributed.

Senator LA FOLLETTE. Furthermore, if he sells, he only pays the capital gain and he does not pay the surtax.

Mr. HELVERING. I am referring to the payment of the surtax this year. The corporation of course, on these surpluses can make loans or advances on the market. Outside of their legitimate business, they can do a considerable business that way.

The CHAIRMAN. Is it not a fact that a dividend-paying stock is classified as a little better than one that does not pay dividends?

Mr. HELVERING. I think it should have a higher sales value; yes.

Senator KING. And intrinsically, too, perhaps.

Mr. HELVERING. The Federal Government is thereby deprived of substantial amounts of revenue; and great inequalities in the treatment of different kinds of income, and in the treatment of incorporated as opposed to stockholders and so made to bear their fair share of taxation under the individual income surtaxes, should be subject to corporation income taxes at rates which, on the average, would compensate the Federal Government for the loss in surtax revenue.

Their loss, as the Secretary has indicated, is of very great dimensions. The Treasury estimates that, if the present corporation income, capital stock, and excess profits taxes were repealed, and all corporation earnings during the calendar year 1936 were currently distributed, the income of individuals would be increased by more than 4½ billions of which approximately \$4,000,000,000 would be taxable.

Senator HASTINGS. Let me inquire whether you have made any study as to what would have been the result if you take that back say 5 years, 1935, 1934, 1932, 1931, and the years back to 1929, would that show that continued increase in surplus?

Mr. HELVERING. In this amount, you mean?

Senator HASTINGS. Yes, or approximately that amount.

Mr. HELVERING. Oh, no. The Treasury has estimates for those years, which will be placed in the hearings as to those amounts during those years.

Senator KING. Mr. Commissioner, for my own information, I would like to know how you can reach any sort of definite and accurate

conclusions as to what tax would be obtained if all or approximately all the dividends had been distributed, unless you know the brackets into which would fall the tax to be paid by the distributees, and by that you would have to know the number of millions of taxpayers and the brackets into which they would fall, because obviously many of these taxpayers to whom dividends would be distributed, would fall in that class where they pay no tax at all.

Mr. HELVERING. Of course, Senator, we depend entirely upon the estimates made by the statisticians, and they have estimated these figures which I am now reading. I am depending on them for those estimates.

The CHAIRMAN. It will show in the chart.

Mr. HAAS. Mr. McLeod could very probably give the fundamental basis upon which they base the whole estimate of their work. In other words, a similar basis that a life insurance actuary would use to base his estimates. We have something which we think is just as substantial as that to start with.

Senator KING. As I understand then, the tables which you will submit will show the number of stockholders who would be the recipients of dividends and the brackets into which each one would fall?

Mr. McLEOD. We have not indicated the exact number—

Senator GERRY [interposing]. Mr. Chairman, we cannot hear a word of this.

Mr. McLEOD. We have not indicated in that table the exact number of individuals who would receive dividends by the brackets. We have indicated the total number of individuals and the total additional number. We do know from past years where the dividends fall by brackets, and it is somewhat similar to an actuarial table by which an actuary determines the probable length of a man's life and his premiums. He does not trace a particular individual, but he knows from a certain group of individuals, on the average, how many will die in a certain year.

On that same basis, we know that when you have the total number of net incomes of the corporations distributed—we have the records over a period of years—we know on the average how those dividends flow through the income brackets. That is really the basis of the estimate of the additional revenues.

The CHAIRMAN. All right, Mr. Helvering. You may proceed, please.

Mr. HELVERING. About \$1,448,000,000, it is estimated would go to individuals whose effective surtax liability on the additional income would be less than 16 percent.

Senator LA FOLLETTE. You refer to 16 percent there as the average of what the corporations pay now under existing law?

Mr. HELVERING. Taking that as the basis to get this table.

And some \$2,567,000,000 of the additional income would go to individuals whose effective surtaxes on the additional income would be greater than 16 percent, as is illustrated in a chart I should like to put in the record.

The CHAIRMAN. We will have another demonstration made of that chart before we get through so that the public may be let in on it.

Mr. HELVERING. In consequence, the yield of the individual income tax, assuming no change in rates other than the removal of the present exemption of dividends from the normal tax, would be increased by more than \$1,700,000,000 if such distribution were made.

It is estimated that more than 71 percent of the increase in taxable income would be received by individuals with net incomes of more than \$25,000 a year, and that about 45 percent would be received by individuals with net incomes in excess of \$100,000 a year.

This increase in revenues that would result from a full and effective application of the existing individual income tax schedules indicates the extent to which the existing law results in a loss in revenue to the Federal Government. But besides yielding substantial additional revenue to the Federal Government, the proposed method of taxation would eliminate the two main sources of inequality in our tax system.

Under our present laws, individuals and members of partnerships must pay income surtaxes on the entire amount of their earnings, whether such earnings are distributed in full, partly reinvested, or reinvested in their entirety. Corporation earnings which are reinvested escape income surtaxes for the time being and may escape them altogether or become subject to them later at much lower rates.

Senator GERRY. Have your statistics—you must have them, I presume—showing how many copartnerships there are in the country, and what the amount of their capital is, and what the amount of their earnings is?

Mr. HELVERING. Yes, sir.

Senator GERRY. You are putting those in the record, are you, so that we can see them, and that will show how much of the business is done in the country by copartnerships?

Mr. HELVERING. I might say, without being held to the exact number, I think there are 205,000 copartnerships with income of \$1,158,000,000. Those incomes from those copartnerships run all the way up from small figures to over \$1,000,000.

Senator GERRY. Will you please put those in the record?

Senator BLACK. The natural tendency of the tax as it has been has been such that by virtue of it a copartnership was compelled to pay tax on all profits while a corporation was not compelled to pay a tax on all profits, and that has been a very coercive influence in causing people to organize corporations, has it not, and would it not necessarily result in that?

Mr. HELVERING. I might say to you, Senator, that in the year 1926 the number of copartnerships and corporations were about equal. The copartnerships have gradually gone down each year and the corporations have gone up, until in this year, the past year, it has resulted in 205,000 copartnerships as against 500,000 and some corporations.

Senator BLACK. In other words, as I understand the point that you have there, if a copartnership made a million dollars of profits and there were two men in the partnership, they were compelled to pay a tax under the present law on every dollar of profit they made whether they reinvested all of it or not, but if the same two men organized a corporation out in Delaware or some other State, and they made that same million dollars of profit, they would be limited to 15 percent or 16 percent. That is all the tax they would have to pay, is it not? So that naturally there is a constant and strong inducement to keep from paying the 50 percent of the profits if they can get out by paying the Government 15 percent by organizing a corporation.

Mr. HELVERING. A little later on, Senator, I give an absolute example of that, computed in dollars and cents.

Senator GERRY. Is that not just saying in other words that your copartnership is treated in taxation the same as the individual?

Mr. HELVERING. Yes.

Senator GERRY. And therefore the idea, when we had the old Jones Amendment Act, was to make the corporation pay the normal tax so as to even it out? Was it not something like that, as I recall the old law?

Mr. HELVERING. I know those considerations were taken up.

Senator GERRY. And then in addition to that, they paid an additional tax besides that, and that was an attempt to even it up between the copartnership and the corporation.

Mr. HELVERING. Yes.

Senator BLACK. As I understand it then, as it came out a year or so ago, there was a gentleman said to own many million dollars worth of stock in various corporations and who paid no income tax. Now, if the corporations in which he was interested hold their increased profits, the corporations would not have paid anything either? If they put it in surplus, they would have paid 15 or 16 percent.

Mr. HELVERING. That is a flat rate.

Senator BLACK. If that had been an individual, he would have had to pay a large amount of taxes to the Federal Government.

Mr. HELVERING. I think there is no doubt about that.

Mr. BLACK. What you are seeking to bring out here is, as I understand it—just one other question. If there were small stockholders in the corporation, distributed over and around the country, who only owned a very small block of stock, who would not have had to pay 15 percent on their normal individual income, it was to their interest to have that money distributed, and so they were injured if the corporation held it and did not pay it out. That is true, is it not?

Mr. HELVERING. On the small stockholder, the tax went up.

Senator BLACK. But the men who owned the large blocks of stock in the corporation, by the millions, two or three millions, have been greatly benefited to the disadvantage of the small stockholders in the way the tax has operated?

Mr. HELVERING. We think that is the result under the present law, yes.

To consider, first, the case of current tax liability, let us take the case of a partnership composed of five equal partners and with total earnings of \$500,000. The Federal Government under the present law would receive \$166,770 of these earnings in individual income taxes, assuming that the partners were single men and had no other taxable income. If these same men conducted their business as a corporation and paid themselves salaries of \$15,000 each, but no dividends, the Federal Government would receive a total of only \$68,710 in income taxes—a difference of \$98,060. Even if this corporation distributed in dividends 50 percent of its earnings under the present law, after payment of \$75,000 in salaries, the Federal Government would still receive \$52,385 less in taxes than it would receive if the business were conducted as a partnership.

Senator HASTINGS. Mr. Helvering, is it true if those five persons were in business as an equal partnership, that they could not take out as an expense any salaries?

Mr. HELVERING. Oh, no.

Senator HASTINGS. They have to pay on all of that?

Mr. HELVERING. That goes in just the same as though they were not in any business at all. If they take out salaries, that goes in as income, and their earnings go in on top of that, and the tax is computed just as though they were individual business men.

Senator HASTINGS. That is, if the five persons were president and vice president and managers and so forth, whatever they call themselves, they would not pay themselves any salary and take that out of the profits of that business?

Mr. HELVERING. You mean when they would make their return?

Senator HASTINGS. When they make their return.

Mr. HELVERING. No; they would have to include that salary as part of their return, together with all the other interests and profits and their pro-rata share.

Senator KING. But they could take out the salaries paid to the employees?

Mr. HELVERING. Oh, yes; other than the owners. Also depreciation, depletion, and all that sort of allowances under the present law.

Through withholding earnings, moreover, and paying them out only as those in control elect, a corporation is able to average the earnings and the losses of its stockholders over an indefinite period of years, and it is also able to speculate on the possibility that the Congress in some years may be induced to lower individual income-tax rates. It may retain earnings at times when the Government needs additional revenues, and pay them out when tax rates are lowered. The individual does not have these opportunities. If he had a large income in 1929, for instance, he paid in 1930 a tax based exactly on that 1929 income, in whatever brackets of taxation it might fall. If he suffered heavy losses in 1930 and 1931, he was not able to make any deduction or obtain any refund of the taxes he had already paid and for which he had already become liable on his 1929 income. If that same individual's activities had been incorporated, he need have paid individual income taxes only on that portion of his earnings that he withdrew in the form of salary and dividends during the good year to meet his current needs, and by withholding the remainder he would have been able to offset the losses that he sustained in the two succeeding years. That is one door of escape, and it is a most important one.

A second source of inequality is the opportunity enjoyed by owners of corporate businesses to reduce their income taxes by taking part of their income in the form of so-called capital gains. By withholding earnings from distribution, a corporation builds up enhanced capital values which are reflected in the worth of its stock. After a block of that stock has been held in the same ownership for a number of years, it can be sold and the resulting gains in value will be taxed at lower rates than other sources of income. As an instance, if the stock has been held for more than 10 years and then sold, only 30 percent of the resulting gain from its sale will, under the present law, be taxed as income, and if the individual's surtax rates have thus been brought as high as a bracket of 50 percent, he will pay a tax equal to only 15 percent of the whole amount of his gain. This is referring to capital gain. A few years ago, the wealthy stockholder faced only a 12½-percent tax on capital net gains.

But there is a very great number of instances in which corporate earnings have continued to pile up year after year for a far longer period than 10 years, constantly adding to the value of the estates of

their individual owners, without ever having been subject to any surtax taxation, but only to the ordinary corporation income taxes at rates rarely higher than 15 percent. What this means in simple terms is the privilege of reinvesting earnings without the payment of surtaxes upon them, a privilege of very great monetary value to those whose income reach surtax brackets higher than 15 percent. This means anyone whose surtax net income is more than \$22,000 a year.

Now, the President has suggested that the Congress enact a tax measure which will produce approximately the same revenue from corporate earnings, whether they are distributed or not distributed. He suggested also the repeal of the present corporation income tax, the capital-stock tax, the excess-profits tax, and the repeal of the present exemption of dividends from the 4 percent normal income tax; all these taxes to be replaced by a tax on undistributed corporate earnings.

The Ways and Means Committee of the House has applied the principle suggested by the President in a form which expresses the tax not as a levy upon that portion of corporate income which is not distributed in the form of dividends to stockholders, but as a levy on total income. The House bill contains schedules which apply to the entire adjusted net income of a corporation, at rates graduated according to the proportion of the income which is retained by the corporation after the distribution of dividends and after payment of tax. It apparently has been thought by the House committee that this form of expression of the tax rates will more clearly represent to the corporation stockholder the tax cost of retaining any given proportion of net earnings for capital purposes.

Probably the first thing to be noticed about the rates for permanent corporation taxes in the House bill is that any corporation that distributes all of its current earnings will pay no Federal corporation taxes whatever. Such tax as applies will be paid by the individual stockholders on the same basis as all other individual income taxes are paid.

Senator KING. Supposing you have a corporation that is closely held, that has three or four or five or six stockholders, and any dividends that are paid would be paid to them, they could declare a dividend and distribute the profits during the year to themselves, and the corporation would pay no tax at all?

Mr. HELVERING. Absolutely.

Senator LA FOLLETTE. But they will pay on their individual income tax?

Senator KING. Yes; but the corporation would pay no tax.

Senator LA FOLLETTE. In paying the individual income tax they would pay more than they are paying now?

Mr. HELVERING. It is possible that there may be some corporations in the United States that would pay no corporation tax under this proposal.

Let us see what will occur in the case of corporations which do not distribute their earnings fully. Two sets of rates have been presented by the House committee, one applying to corporations with adjusted net income of \$10,000 or less; the second applying to corporations with adjusted net incomes of more than \$10,000, with a provision for merging the effect of these schedules on corporations with adjusted net incomes between \$10,000 and \$40,000. That is the same thing that the chairman was referring to awhile ago in the suggested matter that you want to have put in the record. The small income corpora-

tions, which comprise approximately 80 percent of all nonfinancial corporations, will be able to retain up to approximately 40 percent of a year's earnings for capital purposes and still pay less tax than they pay now. Corporations with large incomes will be unable to retain about 30 percent without paying as much in taxes as are paid under the present law.

Senator LA FOLLETTE. It is my understanding, Mr. Commissioner, that a study of the distribution of dividends over a period of approximately 10 years indicates that on the average corporations normally retain about 30 percent.

Mr. HELVERING. Yes; I think that is what the tables show over the period from 1921 to 1931. I do not know as those are the years, but it is over a 10-year period.

Senator KING. Where do you draw the line of differentiation between the small corporation and the large corporation?

Mr. HELVERING. Income of \$10,000 or less is provided for in the House bill, adjusted net income of \$10,000 or less, for the small corporation.

I have studied the application of these schedules to various types of corporations, large and small, and I have found that in addition to the opportunity given corporations to avoid all Federal income taxation by making full distributions of current earnings, the schedules permit very liberal additions to surplus from current earnings upon payment of taxes lower than those now in effect.

Where, then, does the increased revenue come from? It comes primarily from stockholders already enjoying large incomes who would pay higher taxes on their incomes as these incomes are increased by additional dividend distributions. It would come, in other words, primarily from those who are now able to avoid their just share of the burden of income taxation by holding income-producing property in the corporate form, and by having their corporations retain very large proportions of these earnings, subject only to the ordinary corporation income tax. It is equitable and it is a source of great loss to the public revenues to permit the corporate form to be used by wealthy persons to avoid out graduated individual income surtaxes.

As your committee is well aware, the objectors to bills providing additional revenues are always many and the advocates are usually few, because the benefit is general whereas the hurt is specific. It is natural, also, for some to advocate increasing the present corporation income-tax rate even as high as 25 percent, in lieu of the present proposal.

I might say to you gentlemen that some of the witnesses appearing before the House Ways and Means Committee were so strongly in opposition to this proposal that they even admitted they would pay 25 percent State income taxes on corporations rather than have this proposition.

Senator CONNALLY. Mr. Commissioner, the basic theory of this plan is that the Government will exact the same tax in the aggregate, whether the revenue is held in the Treasury or whether it is distributed to the stockholders, because if it is distributed to the stockholders they will then pay individual income taxes, just as they do pay their income taxes now, is that correct?

Mr. HELVERING. The idea is to put all the income through the tax mill in either one form or the other.

Senator CONNALLY. In the same relative ratio?

Mr. HELVERING. Yes; and the statisticians have advised me that the rates in the retention, the rates that are retained, that are payable by the corporation, are comparable to those paid by the individuals.

Senator CONNALLY. Then it becomes largely a matter of mechanics and calculation as to what the rate should be on the proportion of the income distributed and that proportion that is retained in the Treasury, is that true?

Mr. HELVERING. Oh, yes. But such a substitute would victimize corporations generally, as well as heavily penalizing small stockholders, in order to enable a relatively small number of wealthy individuals to continue to use the corporate form as a means of avoiding individual surtaxes.

The bill passed by the House of Representatives was the product of very painstaking and conscientious consideration by the House Ways and Means Committee, which was assisted by officers of the Treasury Department and the experts of the Joint Committee on Internal Revenue Taxation and of the Office of the Legislative Counsel. In accordance with its desire to take full account of the practical requirements of different types of corporate business enterprises, the committee, while maintaining the principles of the President's proposal, made special provisions for special cases.

Senator WALSH. Mr. Commissioner, have the larger corporations been predisposed to set aside a larger percentage of their earnings as surpluses than the small corporations, so-called, or is there any rule that runs through these corporations?

Mr. HELVERING. No, Senator. Some very large corporations distribute almost fully. There is no general rule.

Senator WALSH. There are apt to be just as many small corporations that retain more than 30 percent of their earnings in surplus as the larger corporations?

Mr. HELVERING. Yes. I do not know whether it is in here, but the small corporation could, under the schedule as provided in the House bill, retain about 40 percent.

I have already noted that the rates of tax proposed for small-income corporations, which comprise the large majority in number of all corporations, are substantially lower than those for large-income corporations. In addition, the bill makes very liberal provision for the retirement of corporate indebtedness. It likewise makes special provision for banks and insurance companies, for corporations in receivership, for different classes of foreign corporations, for affiliated corporate entities, and so forth.

Senator HASTINGS. Mr. Commissioner, why is there special consideration for the banks?

Mr. HELVERING. Well, that was a matter of policy which the Committee on Ways and Means thought it advisable to place in the bill.

Senator HASTINGS. Was that recommended by the President?

Mr. HELVERING. It was not, as I understand it.

Senator HASTINGS. Do you see any particular reason why a special provision should be made for the banks?

Mr. HELVERING. Well, there were certain conditions that were presented to the Ways and Means Committee, and they decided, or they thought there should be some consideration.

Senator HASTINGS. I am asking for your judgment now.

Mr. HELVERING. Well, the Treasury's viewpoint about it is that the bill should be made almost universal.

Senator HASTINGS. Then it is your judgment that there is no particular reason for making a distinction, so far as banks are concerned?

Mr. HELVERING. I do not see any, Senator, when you take into consideration the amount of the exempt income that they have.

The CHAIRMAN. But you did deal the same with the banks as you dealt with the insurance companies and some other companies?

Mr. HELVERING. Yes.

The CHAIRMAN. There are certain States that compel banks to carry certain amounts of surplus, are there not?

Mr. HELVERING. Yes.

Senator BLACK. What other kind of companies? The Chairman said "banks, insurance companies and other companies."

The CHAIRMAN. Trust companies, companies in receiverships.

Mr. HELVERING. The whole idea, as I understood from the discussions in the Ways and Means Committee, was to put into a special class and give a flat rate to those companies, that could not, by virtue of their situation, like being in receivership, and things like that, come under this provision without a hardship.

Senator BLACK. Was there an exemption given to all types of insurance companies?

Mr. HELVERING. No. The schedules have reference to fire-insurance companies, life-insurance companies, and another one.

Senator BLACK. Fire and life, and that is all?

Mr. HELVERING. Mutual, all sorts of insurance companies.

Senator BLACK. Then the exemption includes all kinds and types of insurance companies?

Mr. HELVERING. Well, there are some insurance companies of the mutual class that are exempt under the present law, and those are left exempt under this.

Senator BLACK. What I was getting at, does it exempt all types of insurance companies, the liability-insurance companies, fire, life, and so forth, or does it exclude from the exemption some kind of insurance companies?

Senator GEORGE. I understood it was applicable only to mutual insurance companies, other than life.

Senator CONNALLY. He is talking about the 15-percent rate.

Mr. HELVERING. The 15-percent rate generally applies to stock companies, I will say that.

Senator HASTINGS. What I have in mind, take the case of an insurance company, which is the extreme case, in the first place has to have a certain reserve set aside to make its contract a good contract, but it is engaged in business for profit, and if it makes a large sum of money why should not it be compelled to pay out its dividend just like any other business corporation, when you separate the surplus earnings from the surplus that is necessary to make the policy good?

Mr. HELVERING. Well, in the discussions in the Ways and Means Committee they have taken into consideration various requirements in the States, as required by law in those various States, on the question of reserves.

Senator HASTINGS. Well, that could certainly only be the kind of reserve that is required to make the policy good. Now I am talking about another reserve, I am talking about the reserve that grows out of the profit of the corporation. I do not see why, in the case of a

bank, in the case of an insurance company, I do not see any particular reason for making the distinction. I am just trying to find out. There may be some good reason.

Mr. HELVERING. Well, we did not recommend a change.

The CHAIRMAN. Well, Mr. Commissioner, as a matter of fact life insurance companies fall into two classes.

Mr. HELVERING. Yes, sir.

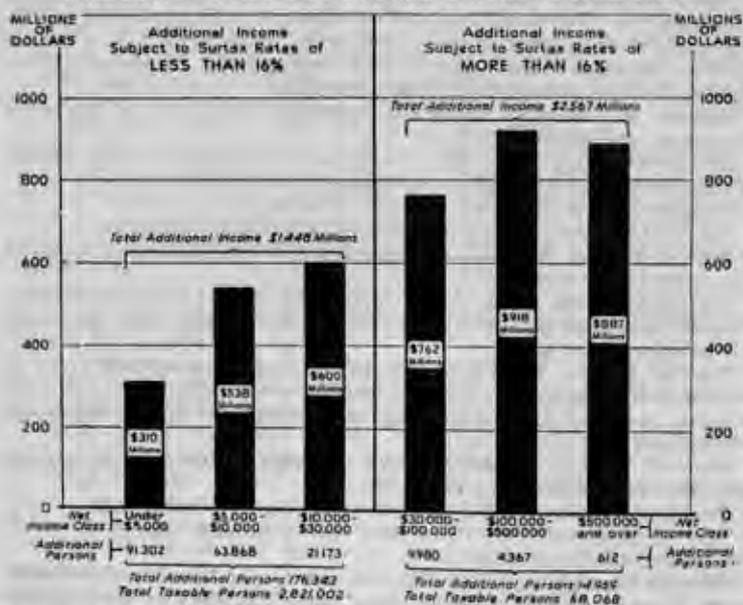
The CHAIRMAN. The stock-insurance companies and the mutuals.

Mr. HELVERING. Yes.

The CHAIRMAN. The mutuals are not taxed under this, they are taxed under another provision of the bill, is that right?

Mr. HELVERING. Yes. I feel that the House bill provides the basis for an excellent and productive revenue measure. In the first

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Assuming All 1936 Estimated Corporate Earnings Were Distributed



place, it would remove great existing inequalities in the taxation of incorporated and unincorporated business, as well as in the treatment of business profits generally.

Senator CONNALLY. Mr. Commissioner, that is a point there that I think particular attention ought to be directed to. Is it not true that under the existing law the operation is really favorable to corporate incomes as against individual incomes, against individuals who might be engaged in the same business?

Mr. HELVERING. No question about it, Senator, at all.

Senator CONNALLY. In other words, the corporation pays a flat 15-percent tax, and if it holds the balance of its profits in surplus nobody pays more than 15 percent, whereas the individual who had a comparable income might pay 20, 30, 40, or even 50 percent, is that true?

Mr. HELVERING. That is true, and also in that connection, to the small stockholder in that same corporation the 15 percent is a penalty.

Senator CONNALLY. The small man may not pay any income tax individually and yet he would pay 15 percent on the corporate tax, is that true?

Mr. HELVERING. Yes. In the second place, it would increase the Federal revenues by eliminating important sources of tax avoidance rather than by increasing existing tax rates or imposing new taxes.

The CHAIRMAN. Are there any questions of the Commissioner? If not, we will proceed with Mr. Haas.

Senator BLACK. Mr. Helvering, was there some question that came up in the House with reference to the profits over 6 percent made by the Federal Reserve bank? Did the Treasury Department recommend that all profits over 6 percent be taxed?

Mr. HELVERING. No, I do not think so. I think there was some discussion by some members of the committee during the hearing on that question.

Senator BLACK. Was there any provision made for that in the pending bill?

Mr. HELVERING. No. You mean profits?

Senator BLACK. Profits over 6 percent in the Federal Reserve, or placing it back into the Treasury.

Mr. HELVERING. No, there is nothing in the bill on that. I remember it was mentioned. Mr. Oliphant just advised me that in the hearings one Member of the House appeared before the committee and talked on that subject.

Senator BLACK. Did the Treasury Department take any position on it?

Mr. HELVERING. No, we did not.

The CHAIRMAN. Congressman Patman talked on that proposition.

Mr. HELVERING. Yes, I think it was Patman.

The CHAIRMAN. All right, Mr. Haas.

#### STATEMENT OF GEORGE C. HAAS, DIRECTOR OF RESEARCH AND STATISTICS, TREASURY DEPARTMENT

The CHAIRMAN. Mr. Haas, will you designate your position?

Mr. HAAS. My name is George C. Haas. I am Director of Research and Statistics of the Treasury Department.

I appear here at the request of the Secretary of the Treasury to discuss some of the broader economic aspects of the proposed change in our system of corporation taxes. I should like to analyze the considerations involved as objectively as possible; but I think that I can be of most service to the committee if I do this mainly by discussing each of a number of objections that have been raised, either in the House hearings or in the press, against the proposed change. There will possibly be some factors that I shall treat in lesser detail than some of the members of this committee may desire; but if this proves to be the case, I shall be glad to provide such additional data and discussion as the committee may request.

Because of the legal distinction between a corporation and its stockholders, only that part of a corporation's earnings which is paid out in dividends is subject to our individual income taxes, even though the retained earnings add equally to the net worth of the stockholders. These withheld corporate earnings, if fully distributed, would go very largely to individuals of large incomes—indi-

viduals subject to the higher-bracket rates in our individual income-tax schedules. When retained by corporations, on the other hand, these earnings are subject to corporation income taxes of only 12½ to 15 percent. In consequence, the Federal Government is deprived of very substantial amounts of revenue which it would otherwise receive under the existing individual income-tax rates. It is estimated by the Treasury, for example, that about 45 percent of the withheld corporate earnings of the calendar year 1936 would, if distributed, go to individuals subject to income surtaxes ranging from 58 to 75 percent of the amount of this additional income.

The main objections which have been advanced against the proposed change in corporation taxes are:

(1) It is contended that small corporations will be prevented from growing into big ones and that, therefore, existing big corporations with accumulated surpluses will not face sufficient competition, hence, fostering monopoly.

(2) It is contended that all corporations, large as well as small, will be prevented from securing sufficient capital for expansion and other legitimate purposes.

(3) It is contended that capital will be driven into tax-exempt securities.

(4) It is contended that the change will prevent the creation of corporate surpluses necessary to maintain dividends, wages, employment, and business solvency through periods of depression.

Let us examine each of these objections in turn.

First. Those who foresee difficulties for the small corporation in the proposed legislation cannot have analyzed closely the schedules incorporated in the House bill. Much lower rates are provided for corporations whose net incomes are \$10,000 or less than are provided for larger corporations. For example, if a small corporation—

Senator GERRY. One minute there. Is that accurate? Let me see if I understand this provision. You say here much lower rates are provided for corporations whose net incomes are \$10,000 or less than provided for larger corporations.

Mr. HAAS. Corporations with a larger income.

Senator GERRY. With a larger income?

Mr. HAAS. That is right.

Senator GERRY. That is what I am driving at. What you do here, it does not make any difference how big the corporation is, it could be a billion dollar corporation, but if it earns \$10,000 it pays a lesser rate?

Mr. HAAS. That is right.

Senator GERRY. That corporation may have just two stockholders and they would get the benefit?

Mr. HAAS. That is right.

Senator GERRY. For example, if a small corporation retains 10 percent of its adjusted net income, I think it paints the wrong picture, because it does not mean a small corporation necessarily, it means a corporation with a small income.

Mr. HAAS. It should have been more precisely stated if you are correct, Senator.

Senator GERRY. Well, this does not mean that it is a small corporation. It is a corporation with a small income.

Senator COZENS. It means it has a small income in a small corporation.

Senator GERRY. It is a corporation with a small income. That is what I am driving at. This has nothing to do with capital, this has to do with income.

Mr. HAAS. That is right.

Senator GERRY. I think that is a very misleading statement.

Mr. HAAS. You are correct. It has to do entirely with income. Much lower rates are provided for corporations whose net incomes are \$10,000 or less, than are provided for larger corporations. I use that general expression in my statement. You are right. It is not precise, but it clears itself up.

Senator GERRY. I know perfectly well the Treasury does not want to give the wrong impression, but I also know that it led me astray the other day when I questioned one of the experts on it. I just wanted to raise that point, of course, so it would be clear in the record, because it gives the wrong impression.

Mr. HAAS. Much lower rates are provided for corporations whose net incomes are \$10,000 or less than are provided for corporations with larger incomes. For example, if a small corporation retains 10 percent of its adjusted net income, its tax will amount to 1 percent of its adjusted net income, as compared with a tax of 4 percent levied against corporations with incomes in excess of \$10,000 which retain the same percentage of their adjusted net income. Similarly, with retentions of 20 percent of the adjusted net income, the tax is 3½ and 9 percent of the adjusted net income for small and large corporations, respectively. If 30 percent is retained, the small corporation pays 7½ percent, as compared with 15 percent for the larger corporation. We estimate that 83 percent in number of all corporations reporting net incomes for 1936, or 214,000 out of a total of 257,000, will have incomes of \$10,000 or less. Under the provisions of the House bill, such corporations can withhold and directly reinvest in the business about 40 percent of each year's earnings without paying as much in corporate taxes as at present. This is a much greater proportion than can be reinvested by the larger corporations without the payment of a substantially higher rate of tax. Both classes of corporations could sharply reduce the present amount of their taxes by distributing a larger proportion of their current earnings. But regardless of their policies in this respect, the rate schedules give a decided advantage to the small corporations.

But, as you all know, the capital funds available for profitable corporations, whether large or small, are not limited to the amounts that they can save directly from earnings. Corporations that desire additional capital for expansion or other purposes can obtain such capital by the sale of additional shares to their own stockholders or to investors generally.

In the case of small corporations with a limited number of stockholders, it is almost as easy to pay out earnings in dividends and have all or a part of them resubscribed by the stockholders—such as Senator King suggested there—for additional shares of the corporation's stock, as to reinvest them directly. It is merely a matter of convenience and tax economy which method shall be followed. Under the present system of income taxation both considerations have tended to favor the process of direct reinvestment, and hence the examples taken from the growth of corporations over the period during which this system has been operating have naturally showed small corporations growing into large ones by this method. The method of resubscribing dividends, however, would be equally effective.

I have already pointed out that under the proposed law small corporations would have a substantial advantage over large ones in the direct reinvestment of earnings. They would similarly enjoy two advantages in the process of growing through resubscribed earnings. In the first place, the very compactness of a small corporation permits this process to be carried on with a directness and informality which is impossible for the larger corporations. If under the present law small corporations retain their earnings through the consent and agreement of their stockholders, under the proposed plan, stockholders would be every bit as likely to use the proceeds of their dividend checks from the corporation to reinvest in additional stock.

Senator GERRY. In that case, Mr. Witness, again you are referring to this small corporation, all the way through in your argument, as a small corporation. Now under this provision it is not necessarily a small corporation, it may be a very large one. It means a corporation with small earnings?

Mr. HAAS. You are exactly right, but, Mr. Senator, I think in this statement which I am about to make, that as a general rule small corporations have small incomes. It is the exception where you have large corporations with exceptionally small incomes, and it is in an exceptional period.

Senator GERRY. It does not say "small income." That is the thing that I went astray on before, that I was confused on. That is why I want to clear it up. It may be a small corporation but it has a large percentage of earnings for that corporation. Is that true?

Mr. HAAS. What I meant was that they are small corporations with small earnings.

Senator GERRY. I know what you mean now. We want to make the thing clear, so that it will not be confusing for us when we try to study the bill. What you really mean is a small corporation with small earnings.

Mr. HAAS. That is right. Thank you for the correction.

Senator LA FOLLETTE. But the principle is no different, is it, Mr. Haas? We do not tax an individual taxpayer today on his total worth, or his gross income, we tax him on his net?

Mr. HAAS. On the income it produces.

Senator LA FOLLETTE. Yes. And it is simply applying the same principle as the basis of taxation to corporations that we now apply to individuals?

Mr. HAAS. That is right.

Senator GERRY. If the Senator from Wisconsin will permit me, I agree with what he says entirely, I have no complaint with it, but what I had complained of was that the inference went out that the small corporation was necessarily getting a benefit under this requirement. Now it may or it may not, but in a great many cases it does. That is why the other day I asked for statistics, for example, on the number of stockholders that came under this group, and I think the Treasury was going to try and find them for me and bring them up. That is why I wanted to know how many this affects, and whether it really does affect a great many corporations.

Senator CONNALLY. Mr. Haas, wherever you say "small corporation" in this statement you mean a corporation with a small income?

Mr. HAAS. That is right.

Senator LA FOLLETTE. As I understand it, as a general rule it is a fact that corporations with a small income are likely to be small corporations. As I understand it, the figures show that 67 corporations in 1933 had about one-third of the total corporate income of the country.

Senator CONNALLY. After all, under this bill it is immaterial whether it is big or little, it is the income that is material, whether the income is big or little is a factor. When you say a small corporation you mean a corporation with a small income?

Mr. HAAS. The basis for classification is income. If you once classify them large or small on that criterion you can call them small or large, once you have made yourself clear.

Senator GERRY. I am just trying to clarify this thing.

The CHAIRMAN. As a matter of fact, as the result of improved economic conditions in the country, there are not many large companies or corporations that are not making a pretty fair earning, isn't that true?

Mr. HAAS. The corporate earnings, Mr. Chairman, have recovered in a very remarkable percentage. For instance, in the calendar year 1935 the percent increase in corporate earnings was about 42 percent. In the last quarter of 1935 the percentage increase over the same quarter of the year previous was about 117 percent. So there have been very remarkable increases in corporate earnings recently.

Senator LA FOLLETTE. Is it not a fact that a reliable index indicates that a group of 1,307 corporations in 1935 increased their earnings 32 percent above those for 1934?

Mr. HAAS. That is correct, Senator La Follette.

Senator LA FOLLETTE. And that a group of 161 representative corporations showed an increase of 69 percent?

Mr. HAAS. That is right.

Senator LA FOLLETTE. Is it not a fact that these 161 corporations showed that the profits during the last quarter of 1935 were 117 percent higher than the profits for the last quarter of 1934?

Mr. HAAS. That is correct, Senator. I think those are Standard Statistics figures.

Senator GERRY. You haven't got any statistics yet, you are trying to get them for me?

Mr. HAAS. Yes.

Senator GERRY. How many corporations will this affect? How many stockholders will this affect? I think we have the number of corporations.

Mr. HAAS. Yes.

Senator GERRY. We haven't got the number of stockholders, is that it?

Mr. HAAS. We are working on that. That is a very difficult problem, because one man may own 10 shares of this, 10 shares of something else, and would count them 10 times.

Senator LA FOLLETTE. As I understand, Mr. Haas, the number of stockholders cannot be furnished, the fact that you cannot furnish those figures is not a basis for questioning the reliability of your estimates as to the distribution of corporate income if it is paid out of the corporations and into the hands of individual taxpayers?

Mr. HAAS. You are absolutely correct, Senator.

Senator LA FOLLETTE. In other words, you have sufficient actuarial samples so that you are willing to stake the revenue of the Government on the proposition that those samples and estimates are correct, and as a general rule the distribution will work out as you estimate?

Mr. HAAS. That is correct.

Senator GERRY. Of course the Senator from Wisconsin is going to address himself to one point, which is the total revenue. What I was trying to get at is the basis of the special exemption.

Mr. HAAS. How many people are involved?

Senator GERRY. Yes; and on what it was based. Just a general idea.

Mr. HAAS. I think we can get you what you want.

Senator GERRY. I just want a general idea.

Senator BLACK. Mr. Haas, as I read your statement here this morning, what you are simply pointing out is the mechanics. The stockholders of the small corporation would have an advantage of resubscribing. The mechanics would have to be utilized by the subscribers of the large corporation. I do not see where this refers at all to the man of means. What you are referring to here is making an argument to reply to another argument that the small corporations would be injured by reason of the failure to be able to bring about a resubscription. You are pointing out that a small corporation, irrespective of income, which has nothing to do with it, would not be handicapped or harrassed in any manner because the small corporation can much more easily bring about a resubscription of the stock?

Mr. HAAS. That is right.

The CHAIRMAN. You may proceed.

Senator GEORGE. Mr. Haas, before you proceed, in enumerating the objection here I note that you do not refer to one that has been suggested. I think, in certain quarters, at least it occurs to me, the difficulty that may arise out of the small holder of stock in the corporation being insistent, his insistence that there be no retentions, whether the corporation be large or small, no reserve set up. Have you given consideration to that objection? I refer particularly to the shareholder who might be described as a speculative shareholder. That does not tie into the corporation on the basis of investment so much, as he is simply speculating in stocks. The holder of a relatively small amount of stock of course would constantly agitate, constantly insist on a complete distribution of the earnings regardless of the condition of the corporation. It is easily imaginable, of course, that he would pay little, if any, tax, even if his entire share was distributed, whereas if there were withheld in the corporation any particular amount of money he would pay his proportionate share through the corporate tax.

Mr. HAAS. Yes.

Senator GEORGE. In other words, the objection is simply this: There is the tendency in this bill to transfer management and control in the corporation from the majority of the officers and directors to a troublesome minority, particularly speculative purchasers of stock. That seems to me to be an objection that might well be considered, and I am making the suggestion to you now so you may think it over, so that you may express some view on it by tomorrow morning.

Mr. HAAS. I will be very glad to do that. Shall I proceed?

Senator LA FOLLETTE. I would just like to interject a general observation that the experience in management of corporations does not seem to indicate that minority stockholders have much to say about the policy of the corporation.

Senator GEORGE. But they would have under this program much to say about it.

The CHAIRMAN. This matter is so important that I think you had better proceed in the morning. The committee will take a recess until 10 o'clock tomorrow morning.

(Whereupon, at 12 noon, the committee recessed until tomorrow, Friday, May 1, 1936, at 10 a. m.)

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Statement of Guy T. Helvering, Commissioner of Internal Revenue,  
before the Senate Finance Committee, April 30, 1936.

The Secretary of the Treasury has just presented to you an analysis of the additional revenue needs of the Federal Government, as outlined in the President's Supplementary Budget Message of March 3 and the extent to which these needs are met by the bill passed by the House of Representatives. Having appeared before the Ways and Means Committee, I am glad to place myself at the disposal of this Committee for any assistance I may render. As a preliminary I desire to make a few general statements as to the President's proposal and the House bill.

The first thing to which I should like to call your attention is the fact that in the last analysis none of the three sources of additional revenues suggested by the President involves new taxation. One of them -- the "windfall" tax, so-called -- is designed only to recoup for the Treasury and the public, taxes that were actually paid by numerous business firms and by consumers generally, but which became part of private, rather than of the public revenues. Another -- the proposed tax on corporate earnings, coupled with the repeal of the existing corporate income, capital stock, and excess profits taxes -- is designed only to make effective the present schedules of income tax rates applicable to individual incomes, by reducing the opportunities for tax avoidance and tax evasion. The

third was for the enactment of processing taxes on a broader base, but with lower rates, than those that were in effect under the Agricultural Adjustment Act. The suggested processing taxes, therefore, would only replace the similar taxes previously in force; and, moreover, are proposed for only a temporary period.

The President's suggestion to obtain additional permanent revenue was for an improvement in our method of corporate income taxation. In essence, as I have already indicated, this proposal does not seek to impose any new taxes or any higher rates of taxes. On the contrary, its effect would be to lower taxes for a great many, perhaps the great majority, of our corporations; and to lower them also for a very large proportion of corporation stockholders. The fundamental objective of this proposal is to increase the Federal revenues by plugging up a major source of tax avoidance and tax evasion now existing; and thereby greatly to increase the fairness and balance of the Federal income tax structure as a whole.

The President's proposal, the principles of which are incorporated in the House Bill, is no new development. It has received the attention and support of students of taxation from the earliest days of income taxation in the United States. Its principles were incorporated in our first income tax law, 1862-1871, when Congress provided that the gains and profits of corporations should be included in the annual taxable gains, profit, or income of any person entitled to them, whether divided or undivided. Shortly before and while the Revenue Act of

1921 was under consideration, a proposal identical in principle with the President's suggestion received the support of many representatives of organized business, Members of Congress, and the Treasury Department. The principle was recommended by Secretary of the Treasury Houston in his Annual Report for the year 1920. In somewhat modified form, it was incorporated in a bill passed by the Senate in 1924.

When corporations distribute their earnings to their stockholders, the dividends are subject to the surtax rates incorporated in our income tax law. When corporate earnings are not so distributed, the individual stockholders, while enjoying the benefit of those earnings in the form of the increased worth of their securities, are enabled to avoid all payment of surtaxes thereon. The Federal Government is thereby deprived of substantial amounts of revenue; and great inequalities in the treatment of different kinds of income, and in the treatment of incorporated as opposed to unincorporated business, result. The essence of the President's suggestion is that corporation incomes, if not distributed to stockholders and so made to bear their fair share of taxation under the individual income surtaxes, should be subject to corporation income taxes at rates which, on the average, would compensate the Federal Government for the loss in surtax revenue.

This loss, as the Secretary has indicated, is of very great dimensions. The Treasury estimates that, if the present corporation income, capital stock, and excess profits taxes were repealed, and

all corporation earnings during the calendar year 1936 were currently distributed, the income of individuals would be increased by more than four and a half billions of which approximately \$4 billions would be taxable. About \$1,448 millions, it is estimated would go to individuals whose effective surtax liability on the additional income would be less than 16 per cent; and some \$2,567 millions of the additional income would go to individuals whose effective surtaxes on the additional income would be greater than 16 per cent, as is illustrated in a chart I should like to put in the record. In consequence, the yield of the individual income tax, assuming no change in rates other than the removal of the present exemption of dividends from the normal tax, would be increased by more than \$1,700 millions if such distribution were made.

It is estimated that more than 71 per cent of the increase in taxable income would be received by individuals with net incomes of more than \$25,000 a year, and that about 45 per cent would be received by individuals with net incomes in excess of \$100,000 a year.

This increase in revenues that would result from a full and effective application of the existing individual income tax schedules indicates the extent to which the existing law results in a loss in revenue to the Federal Government. But besides yielding substantial additional revenue to the Federal Government, the proposed method of taxation would eliminate the two main sources of inequality in our tax system.

Under our present laws, individuals and members of partnerships must pay income surtaxes on the entire amount of their earnings, whether such earnings are distributed in full, partly reinvested, or reinvested in their entirety. Corporation earnings, however, are not considered as part of the earnings of the individual stockholders until distributed. Corporation earnings which are reinvested escape income surtaxes for the time being and may escape them altogether or become subject to them later at much lower rates.

To consider first the case of current tax liability, let us take the case of a partnership composed of five equal partners and with total earnings of \$500,000. The Federal Government under the present law would receive \$166,770 of these earnings in individual income taxes, assuming that the partners were single men and had no other taxable income. If these same men conducted their business as a corporation and paid themselves salaries of \$15,000 each, but no dividends, the Federal Government would receive a total of only \$68,710 in income taxes -- a difference of \$98,060. Even if this corporation distributed in dividends 50 per cent of its earnings, after payment of \$75,000 in salaries, the Federal Government would still receive \$52,385 less in taxes than it would receive if the business were conducted as a partnership.

Through withholding earnings, moreover, and paying them out only as those in control elect, a corporation is able to average the earnings and the losses of its stockholders over an indefinite period of years, and it is also able to speculate on the possibility that the Congress in some years may be induced to lower individual income tax rates. It may retain earnings at times when the Government needs additional revenues, and pay them out when tax rates are lowered. The individual does not have these opportunities. If he had a large income in 1929, for instance, he paid in 1930 a tax based exactly on that 1929 income, in whatever brackets of taxation it might fall. If he suffered heavy losses in 1930 and 1931, he was not able to make any deduction or obtain any refund of the taxes he had already paid and for which he had already become liable on his 1929 income. If that same individual's activities had been incorporated, he need have paid individual income taxes only on that portion of his earnings that he withdrew in the form of salary and dividends during the good year to meet his current needs, and by withholding the remainder he would have been able to offset the losses that he sustained in the two succeeding years. That is one door of escape, and it is a most important one.

A second source of inequality is the opportunity enjoyed by owners of corporate businesses to reduce their income taxes by taking part of their income in the form of so-called capital gains. By withholding earnings from distribution, a corporation builds up enhanced

capital values which are reflected in the worth of its stock. After a block of that stock has been held in the same ownership for a number of years, it can be sold and the resulting gains in value will be taxed at lower rates than other sources of income. As an instance, if the stock has been held for more than ten years and then sold, only 30 per cent of the resulting gain from its sale will, under the present law, be taxed as income, and if the individual's surtax rates have thus been brought as high as a bracket of 50 per cent, he will pay a tax equal to only 15 per cent of the whole amount of his gain. A few years ago, the wealthy stockholder faced only a  $12\frac{1}{2}$  per cent tax on capital net gains.

But there is a very great number of instances in which corporate earnings have continued to pile up year after year for a far longer period than ten years, constantly adding to the value of the estates of their individual owners, without ever having been subject to any surtax taxation, but only to the ordinary corporation income taxes at rates rarely higher than 15 per cent. What this means in simple terms is the privilege of reinvesting earnings without the payment of surtaxes upon them, a privilege of very great monetary value to those whose incomes reach surtax brackets higher than 15 per cent. This means anyone whose surtax net income is more than \$22,000 a year.

Now, the President has suggested that the Congress enact a tax measure which will produce approximately the same revenue from

corporate earnings, whether they are distributed or not distributed. He suggested also the repeal of the present corporation income tax, the capital stock tax, the excess profits tax, and the repeal of the present exemption of dividends from the 4 per cent normal income tax; all these taxes to be replaced by a tax on undistributed corporate earnings.

The Ways and Means Committee of the House has applied the principle suggested by the President in a form which expresses the tax not as a levy upon that portion of corporate income which is not distributed in the form of dividends to stockholders, but as a levy on total income. The House Bill contains schedules which apply to the entire adjusted net income of a corporation, at rates graduated according to the proportion of the income which is retained by the corporation after the distribution of dividends and after payment of tax. It apparently has been thought by the House Committee that this form of expression of the tax rates will more clearly represent to the corporation stockholder the tax cost of retaining any given proportion of net earnings for capital purposes.

Probably the first thing to be noticed about the rates for permanent corporation taxes in the House bill is that any corporation that distributes all of its current earnings will pay no Federal corporation taxes whatever. Such tax as applies will be paid by the individual stockholders on the same basis as all other individual income taxes are paid.

But let us see what will occur in the case of corporations which do not distribute their earnings fully. Two sets of rates have been presented by the House Committee, one applying to corporations with adjusted net incomes of \$10,000 or less; the second applying to corporations with adjusted net incomes of more than \$10,000, with a provision for merging the effect of these schedules on corporations with adjusted net incomes between \$10,000 and \$40,000. The small income corporations, which comprise approximately 80 per cent of all nonfinancial corporations, will be able to retain up to approximately 40 per cent of a year's earnings for capital purposes and still pay less tax than they pay now. Corporations with large incomes will be enabled to retain about 30 per cent without paying as much in taxes as are paid under the present law.

I have studied the application of these schedules to various types of corporations, large and small, and I have found that in addition to the opportunity given corporations to avoid all Federal income taxation by making full distributions of current earnings, the schedules permit very liberal additions to surplus from current earnings upon payment of taxes lower than those now in effect.

Where, then, does the increased revenue come from? It comes primarily from stockholders already enjoying large incomes who would pay higher taxes on their incomes as these incomes are increased by additional dividend distributions. It would come, in other words, primarily from those who are now able to avoid their just share of the burden of

income taxation by holding income producing property in the corporate form, and by having their corporations retain very large proportions of these earnings subject only to the ordinary corporation income tax. It is inequitable and it is a source of great loss to the public revenues to permit the corporate form to be used by wealthy persons to avoid our graduated individual income surtaxes.

As your Committee is well aware, the objectors to bills providing additional revenues are always many and the advocates are usually few, because the benefit is general whereas the hurt is specific. It is natural, also, for some to advocate increasing the present corporation income tax rate even as high as 25 per cent, in lieu of the present proposal. But such a substitute would victimize corporations generally, as well as heavily penalizing small stockholders, in order to enable a relatively small number of wealthy individuals to continue to use the corporate form as a means of avoiding individual surtaxes.

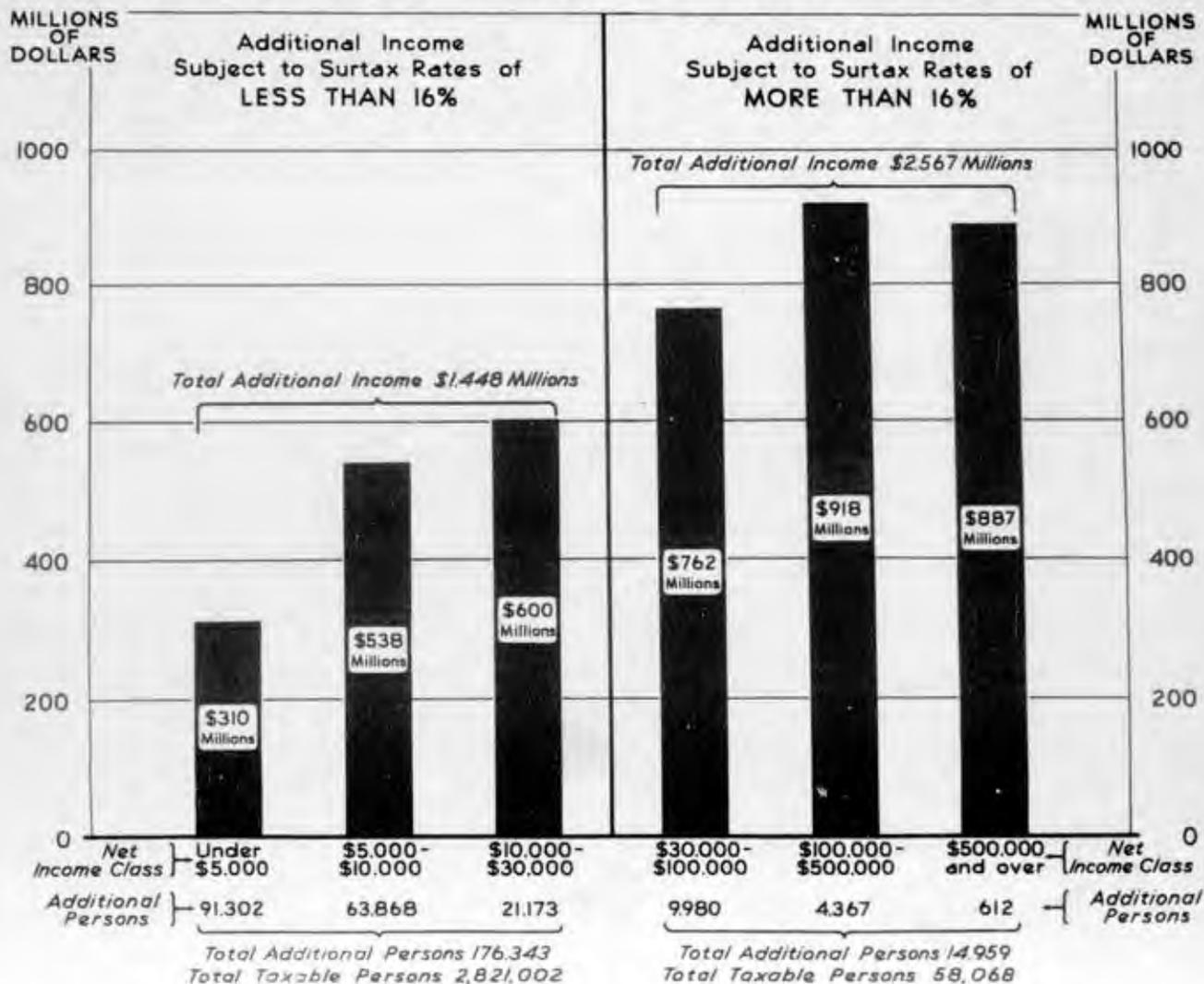
The Bill passed by the House of Representatives was the product of very painstaking and conscientious consideration by the House Ways and Means Committee, which was assisted by officers of the Treasury Department and the experts of the Joint Committee on Internal Revenue Taxation and of the Office of the Legislative Counsel. In accordance with its desire to take full account of the practical requirements of different types of corporate business enterprises, the Committee, while maintaining the principles of the President's proposal, made special provisions for special cases.

I have already noted that the rates of tax proposed for small income corporations, which comprise the large majority in number of all corporations, are substantially lower than those for large income corporations. In addition, the Bill makes very liberal provision for the retirement of corporate indebtedness. It likewise makes special provision for banks and insurance companies, for corporations in receivership, for different classes of foreign corporations, for affiliated corporate entities, etc.

I feel that the House Bill provides the basis for an excellent and productive revenue measure. In the first place, it would remove great existing inequalities in the taxation of incorporated and unincorporated business, as well as in the treatment of business profits generally. In the second place, it would increase the Federal revenues by eliminating important sources of tax avoidance rather than by increasing existing tax rates or imposing new taxes.

## ADDITIONS TO TAXABLE INCOMES OF INDIVIDUALS

Assuming All 1936 Estimated Corporate Earnings Were Distributed



April 30, 1936

The following cable was received via the Customs Bureau from Buck, in Shanghai, for transmission to Dr. Warren:

"Shanghai,  
April 28, 1936

"Commissioner of Customs  
Washington DC  
From Buck to Gorman for transmission to  
G F Warren - Minister Kung is interested  
in your coming to China to advise on mon-  
etary and agricultural problems and would  
like to know when and upon what terms you  
could come. I would suggest you come for  
minimum of six months and longer if pos-  
sible. I would welcome your coming by  
summer so as to read my land utilization  
report before publication. Would want  
your help instruction graduate students  
if possible also. Agricultural policies  
in China are being established very rap-  
idly and not very wisely so your early  
coming should be of great assistance to  
the future agricultural developments of  
the country. (Signed) Jacobson."

HM, Jr. asked Mr. Lochhead to send the following tele-  
gram to Buck:

"Refer your cable April 28 for transmission  
to Warren. This invitation seems to me  
untimely as his trip would undoubtedly be  
interpreted as having great monetary sig-  
nificance rather than agricultural. Un-  
officially suggest that invitation be  
postponed until Chen's mission here has  
been concluded. Message to Warren held  
up in meantime awaiting your further ad-  
vices. (Signed) Morgenthau."

Thursday  
April 30, 1936

Operator: Yes, sir -- Operator --

HMjr: - O'Connor

G: Yes, sir

HMjr: It's very important, I want to talk to him.  
Hello -

Operator: Mr. Davis is on the wire, Mr. Secretary.

HMjr: Who?

Operator: Mr. Davis in Mr. O'Connor's office.

HMjr: All right, hello - hello -

Operator: Here you are.

HMjr: Hello -

Mr. Davis: Hello -

HMjr: Who is this please?

D: This is Davis, Secretary to the Comptroller.

HMjr: All right, this is Mr. Morgenthau.

D: Oh yes, Mr. Morgenthau.

HMjr: Is the Comptroller out of town?

D: No, sir, he is here. They have just been giving Miss Stewart, the retiring Chief of the Examining Division, a little party.

HMjr: I said I was very anxious to talk to him.

D: Yes, sir - well, if you will wait just a second now, Mr. Morgenthau, you can get Mr. O'Connor.

HMjr: Thank you.

Operator: Mr. O'Connor for you.

HMjr: Thank you.

Operator: You're welcome.

HMjr: Hello -

J.F.T.

O'Connor: Good morning, Henry.

HMjr: How are you?

O'C: Fine, thank you.

HMjr: Jefty, have you got a pencil?

O'C: Yes, sir

HMjr: Some people just called me up - they're very much excited about the case of William Speed.

O'C: Oh, yes, I've heard about it the last two days/and Taylor and I talked it over for about a half an hour. Henry

HMjr: Who's Taylor?

O'C: Your man, Deputy -

HMjr: Well, I didn't know about it. (Laughter) Well, let me - let me tell you -

O'C: Yes, come on -

HMjr: - about it. The story, as I get it, that the case - the bank is pending before the Appellate Court.

O'C: That's right.

HMjr: And these people up in New York who are indirectly connected with the New York Times -

O'C: Yes

HMjr: - felt that the thing of selling this man out on Monday could be postponed pending the decision of the Appellate Court.

O'C: Yes

HMjr: That was their plea.

O'C: Yes, yes - and -

HMjr: I mean, it was a friend of the New York Times that called me up from New York.

O'C: Yes - Henry, I went over it very carefully with Taylor because some friends called him and I gave him the whole -

HMjr: Yes

O'C: - attitude of the office and for two days we've been working with these people -

HMjr: Yes

O'C: and tried to work out every conceivable thing with them for over three years and he is represented now by Mr. Newton D. Baker -

HMjr: Oh -

O'C: And we've made them several offers to - we don't want to do an injustice to anybody and this decision in the upper court will not be down for six months or a year and some of the stockholders out there have been secreting and conveying their property.

HMjr: I see.

O'C: And we had to stop that. And we told this chap, Speed, we said, 'Now, we don't want to \_\_\_\_\_ at all. Now, here, if you will take and just give us a trust deed on your property pending the outcome of this case...' -

HMjr: Yes

O'C: '..that'll end it'. He said he wouldn't do it.

HMjr: I see.

O'C: And he had an opportunity to put a bond up to protect our judgment for the depositors and he declined to do that.

HMjr: I see.

O'C: Well, now they've just taken a position that they don't want to do anything for us and here is what I told Mr. Taylor, I said, 'Now, Mr. Taylor, the matter will be before the court out there on Monday and then our responsibility ends. Now, if they come in and make a proper showing and the court says, 'All right, you do this or that', we'll do it'.

HMjr: Yes

O'C: 'But our responsibility ends - now, thank God for it but we have just presented it to the court - '

HMjr: I see.

O'C: ' - and we're not going to, on our side, do anything that is unfair or unjust to him'.

HMjr: Yes - well, I didn't know Taylor had it up with you and what you say - on very little knowledge on my part - sounds reasonable.

O'C: Yes, well I've gone into it myself because it's a big matter and it was one of the things that we inherited here, you know -

HMjr: And you think it's - you think it's being handled in a fair and just manner?

O'C: Yes, I do, Henry. - to the depositors and so there will be no criticism here of the Department.

HMjr: All right, Judge.

O'C: And anything I can do further for him that will not inconvenience him that at the same time protects our people out there I'm willing to do.

HMjr: All right, sir.

O'C: All right, thank you.

HMjr: Thank you.