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Regraded Unclassified
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 - 3:00 P. M.,
April 28, 1936.

1. Industrial use of silver.

Mr. Chen reported that his Government informed him the prohibition
of the use of silver in the arts which had been imposed by the decree
of November, 1935, was to be removed. The Chinese Government was quite
willing to postpone, if the Secretary so requested, announcement of the
change for inclusion in a public statement of the results of the con-
versations with the United States.

Mr. Chen submitted the estimate of 12 million ounces as the annual
amount of silver that had been used in the arts before the 30 per cent
provision was imposed. He felt this estimate to be very conservative.

2. Silver coins.

Mr. Chen reported that his Government had informed him it "agreed
in principle" with his recommendations of the coinage of yuan and half-
yuan coins (described in report of previous meeting). The Chinese
Government was not certain whether the silver content of the new coins
would be the one recommended by Mr. Chen, but it would not be less.
The Chinese Government, however, wished to go slowly in the matter and
therefore intended to first issue only half-yuan coins. If these re-
ceived a satisfactory reception from the public, the yuan coins would
be issued.

It was suggested by the Treasury representatives that if, as Mr.
Chen reported, the Chinese Government definitely intended to issue the
silver coins with at least the recommended silver content, it might be
better to include in the memorandum for the Secretary a more definite
statement than that the Chinese Government "accepts the idea in principle".
Mr. Chen indicated his acquiescence to that suggestion.
3. Silver reserves.

With regard to the suggestion cabled to his Government that it consider the desirability of keeping a minimum of 25 per cent in silver, computed at market bullion value, against the outstanding note issues, Mr. Chen reported that his Government's reply was favorable. His Government was perfectly willing to accept such a suggestion, but it would prefer, if agreeable to the United States, to make the reserve 25 per cent of the cash reserves instead of 25 per cent of the outstanding note issue.

It was pointed out by the Treasury representatives that the latter proposal would tend to weaken confidence in the yuan at this time, and that since China would probably have silver in excess of 25 per cent of her note issue for some time to come, it were preferable, from China's point of view as well as from our own, to have the reserves as first proposed -- namely, a minimum of 25 per cent against note issue.

Mr. Chen then raised the question as to the method of computing the value of the silver in the reserves. He said his Government wished to have it understood that it reserves the privilege of modifying the method of valuation as follows:

(a) To value the silver in terms of old yuans rather than at its world metallic content. The Chinese felt that inasmuch as their silver reserves were chiefly in the form of these old yuans such a practice would be accepted by the public as a most reasonable one.

The Treasury representatives agreed to this, pointing out that such a practice would protect the Chinese against a decline in the value of their reserves should the price of silver decline, and also make it possible for them to increase their reserves in the event of a rise in the price of silver by melting down the old yuans coins and valuing silver at its metallic content.

(b) The second modification proposed by the Chinese Government was that at some indefinite time in the future -- probably after the new yuan coins had become generally accepted into circulation -- the basis of valuing the reserves would be the nominal value of the new yuans.

It was pointed out that this would have the effect of greatly reducing the strength of the reserves inasmuch as the new coins contain much less silver than the old coins. The view was also expressed that such a modification might reduce confidence
in the yuan, since it might be interpreted as a device to permit an undue expansion of note issue. The Treasury representatives stressed the importance at this time of doing nothing which would tend to weaken the confidence of the Chinese people in their currency - a point which Mr. Chen himself never misses an opportunity to reiterate - and it was suggested that a change of that kind in computing the value of the silver reserves were best postponed until China's monetary system was in a stronger position. The Chinese representatives indicated their agreement with this view and said they would recommend to their Government that such a method of valuation be eliminated.

4. Yuan-dollar-sterling exchange rate.

Mr. Koo described in some detail the exchange operations as they had been relayed to him in a cable just received. The altering of the dollar rate, he explained, was a consequence of the adoption of a policy designed to prevent the impression that the yuan was depreciating, and that the currencies happened to have moved in a way necessitating alteration of the official dollar rate in order to avoid that impression. He stated that it was the policy of the Bank to peg its currency to the one which was appreciating, and that had sterling dropped below 4.28 the dollar rate would have been kept unchanged and the sterling rate altered in Shanghai.

It was pointed out that as it has so far worked out this practice made it a little more difficult to accumulate foreign exchange. Nor did the cable satisfactorily explain, from the United States' point of view, why in the first place a fixed sterling rate was selected rather than a fixed dollar rate to provide the impression that the yuan was not depreciating.

It was agreed that a clear, definite statement repeating the fact that the yuan was not pegged either to the dollar or to sterling might be satisfactory in lieu of an opportunity to alter the sterling rate.
Friday
May 1, 1936

HMjr: Cochran?
H. M. Cochran: Mr. Morgenthau

HMjr: Well, what's new today?

C: The franc is rather weak today. There's some selling of dollars by the Guaranty - two and a half billion dollars so far sold.

HMjr: Yes

C: And there may be a little more advance but the peak of the week is in London.

HMjr: I don't get that.

C: People are selling francs directly through the control.

HMjr: Now, say that again.

C: It is that they are going to be today.

HMjr: Well, you say that people are selling francs?

C: Yes, yes the French banks are selling francs directly at London.

HMjr: Yes

C: - through the control.

HMjr: Yes

C: So the British control is handling quite a good many today.

HMjr: Now, say that again, please.

C: I say, there is little trading on the French Market here.

HMjr: Over-trading?

C: There is little trading on the French Exchange Market.

HMjr: What kind of trading?

C: There is very little --

HMjr: Very little trading?

C: It is all being done in London.
In London?

There the Frenchmen and French banks are selling francs directly through the British control.

I see.

The people here are buying dollars to some extent.

They are doing what?

- are buying some dollars -

Yes

- such as two and a half billion sold by my neighbor here today.

Your neighbor?

The Guaranty -

Oh, yes

But most of the franc is in the sterling.

In the sterling?

Yes

Yes

And so the pressure is rather strong today.

There's a what?

The pressure -

Yes

The pressure on the franc is bad.

I don't get that.

I say, the franc is weak.

The franc is weak?

Yes, the pressure on the franc is - is heavy.

I'm sorry, I don't get it.

Well, the franc is weak, that I said.
C: The what?
C: There are many people who want to sell their francs.
HMjr: Yes
C: So it is weak as a result.
HMjr: I don't get that.
C: Well, you do have it that they want to sell their francs?
HMjr: Yes
C: Well, that's the point.
HMjr: I see, all right.
C: They are afraid.
HMjr: I see. Now, anything new on the political situation?
C: No, there is a lot of horse-trading back and forth, you see?
HMjr: Yes
C: But they don't know how complete discipline the Front Populaires will find on Sunday. But it still looks to me as if they will round a big majority.
HMjr: They'll do what?
C: That the Left - that the Left party -
HMjr: Yes
C: - will have a majority on Sunday.
HMjr: I see - and that means the present government will fall?
C: Well - oh fairly good, I think.
HMjr: What?
C: Fairly large - but it's still difficult to tell.
HMjr: And it still looks like Reynaud?
That's the proposition put up by those young men, you know -

I get you.

But there is no public discussion on that whatever.

Yes

But that's the plan those fellows have up their sleeve.

I get you.

If the situation gets bad enough.

Yes

Between you and I - If it doesn't get bad enough then no word is said about it.

Yes

The present man would try to patch up the

Yes

All right - Your cables yesterday were very good.

Beg your pardon?

Your cables yesterday were very good.

All right, fine.

All right

I think I forgot one - I talked to the market people today -

Yes

And the situation with respect to American shares is practically the same.

All right

And I've seen some other people so I'll give you their views.

All right.
C: And on that other matter do you want me to see our friend or not?

HMjr: Well, let's - let's wait until we see what happens in France first.

C: My point is this, that he has returned to Badenweiler.

HMjr: Oh -

C: And he will be there until about the sixth I think. On the sixth he has to go to Breslau to give his speech. And if you wanted me to see him -

HMjr: Yes

C: I could leave here - I could go down on Saturday night.

HMjr: Yes

C: - take an automobile from Basel - it's only thirty miles from Basel and come back on Sunday night's train.

HMjr: Oh, you could?

C: Yes

HMjr: Just be away Sunday?

C: Just be away Sunday.

HMjr: I think that would be a good idea.

C: And I - I've been thinking it over since I talked with you yesterday -

HMjr: I think that would be very good.

C: And I read that - that he had returned there. I haven't tried to get in touch with him directly.

HMjr: Well, if you can be away just Sunday I'd do it.

C: Fine - well, I'll telephone this man at Basel right away.

HMjr: Yes, yes -

C: And if I can get an appointment for Sunday -

HMjr: Yes
C: I'll go down.

HMjr: O.K.

C: Otherwise I'll wait until after the election, -

HMjr: That's right.

C: Takes place.

HMjr: All right, thank you.

C: I'll just try to get general information.

HMjr: That's right.

C: Takes place.

HMjr: All right, thank you.

C: I'll just try to get general information.

HMjr: That's right.

C: Takes place.

HMjr: All right, thank you.

C: I'll just try to get general information.

HMjr: That's right.

C: Takes place.

HMjr: All right, thank you.

C: Goodbye.

HMjr: Goodbye.

C: Goodbye.
May 1, 1936

HM, Jr. called the President and said he had talked to Cochran again and the interesting thing is that the British Stabilization Fund deals directly with the French banks; that the British will do all they can to keep the French from devaluing; that we bought another $500,000 worth of gold last night and that Cochran is going to see Schacht on Sunday -- he knows him personally and is going to see what he can find out.

At the meeting of the group at 9:30, HM, Jr. asked whether the provision in the pending tax bill, which places a tax on undistributed earnings, is fair to the small business man. He said that the way the thing is set up now, companies like Chrysler and General Motors through this bill get an exclusive franchise and that a man who wants to start in business today hasn't a chance. Oliphant suggested that if the tax bill does not permit a small concern to continue in business that the Government could subsidize it, to which HM, Jr. strenuously objected. He said, "That is just what we don't want to do." He feels that under this bill we are doing just what NRA did -- it is a great thing for big business, but ruinous to small business.

HM, Jr. said, "I still have not had an answer to my question as to whether it is fair to the small business man.

Turning to George Haas, he said, "If there are answers, three cheers! But if there are not, let's be big enough to correct this thing and throw it out. The pride of authorship is not the important thing if it is going to hurt small business."
MEMORANDUM FOR THE SECRETARY:

Further conferences were had yesterday afternoon, April 30, with representatives of the Canadian distillers, Seagram, Hiram Walker, United, and Consolidated.

These conferences had originally (with the exception of Hiram Walker) been set for earlier in the week, but were postponed until yesterday at the request of the Canadians.

In the initial conferences which occurred last week, as reported to you in my memorandum of April 24, the Government's conferees made it clear to the representatives of the companies that the companies would be expected to submit specific offers in compromise of the Government's claims, and, in the event these should prove unacceptable, specific proposals to submit to the jurisdiction of our courts and to secure the payment of any judgments which might be obtained. The expectation was that such specific proposals would be made at yesterday's conferences (except in the case of Hiram Walker).

I regret to inform you that, except for United Distillers, the representatives of the companies made no such proposals at yesterday's conferences.

United Distillers.

United Distillers, through Mr. Locke, submitted a specific offer in compromise in the sum of $225,000 (of which $25,000 was for the account of a company known as Coast Breweries). Mr. Locke stated that he had no proposal to make, and would make none, under the second alternative, and indicated that this was the final offer which he was prepared to make. He was informed that his offer would be taken under consideration, and that he would subsequently be advised of its acceptance or rejection.

Seagram.

Mr. Phillips, representing Seagram, made no proposals or suggestions whatsoever. Although he had requested, and had been granted,
No dinner. A trip to Seagram’s distillery at Relay, Md., where the guests were furnished food, all the drinks they cared to consume and a quart to take with them as a souvenir.
more than a week's time to enable him to consult with "interested parties," with a view to making a specific proposal to submit his company to the jurisdiction of our courts and secure judgment, he stated at yesterday's conference that he could make no such proposal. He simply repeated requests which he had made at last week's conferences for information as to the amount and character of security which the Government would consider acceptable. He was informed, as before, that the Government would expect him to take the initiative in this respect. You will recall that at last week's conferences Mr. Phillips made an offer in compromise of $500,000, which was promptly rejected. He at that time indicated that this was the maximum amount which he was prepared to offer in settlement of the Government's claim, and that, in view of the rejection of this offer, his further suggestions would be limited to the second alternative (submission to jurisdiction and securing judgment). At the earlier conferences, there was protracted discussion between Mr. Phillips and the Government's conferees with respect to this second alternative. The Government's conferees made it clear to Mr. Phillips that the Government's position with reference to security was fairly represented by the pending legislation (as revised in conferences between the State and Treasury Departments), but that the Government would be prepared to receive and consider any alternative proposal which Mr. Phillips might care to make.

In view of this, it was confidently expected that Mr. Phillips would submit specific proposals at yesterday's conferences, but, as has been said, he made none.

Mr. Phillips was advised by the Government's conferees that if he cared to confer further with regard to the proposed settlement, he would be given full opportunity to do so, and he advised that he would return to Washington on Monday, May 4, for this purpose. It is presumed that at that time he will submit a specific proposal on the second alternative.

Mr. Phillips indicated his belief that the attitude of the Government's conferees was unfair to his company, and stated that he would be compelled to call this to the attention of the Canadian Government.

Mr. Phillips referred at the outset of yesterday's conference to the entertainment furnished by the Seagram Company on Saturday, April 18, to the so-called "Little Congress." He stated that there was no connection between that episode and the present negotiations, and that he had been unaware that any such thing had occurred until the matter was called to his attention a few days ago by the Canadian Department of External Affairs.

Consolidated Distillers.

Mr. Forsythe, representing Consolidated Distillers, submitted to the Government's conferees the current financial statements of his company, with a view to demonstrating that it was in no financial position
to make either a substantial offer in compromise of the Government's claim, or any proposal to secure payment of judgment. In the end, he suggested that he would be willing to make settlement on the same basis that was followed in the settlement of the Reifel case last August. This would mean a settlement, as he said, in the neighborhood of $125,000. The Government's conferees pointed out that the circumstances surrounding the Reifel settlement were peculiar to that case, and that the Reifel case could not be taken as a precedent for the settlement of claims against other companies. Mr. Forsythe agreed to consider the matter further, and to advise on Monday, May 4, whether he could make further proposals on behalf of his company.

Hiram Walker.

Mr. Lash, for Hiram Walker, advised that he was in no better position than he had been at the earlier conferences to make suggestions for the settlement of the Government's claim. He said that Mr. Hume, president of the company, was to arrive that evening (April 30) in New York, and that until he had seen Mr. Hume he could add nothing to what he had stated at the conferences which occurred last week.

Mr. Lash said that the Canadian Department of External Affairs had called his attention to the fact that this Government had reported that his company did not consider itself bound by the agreement between the two Governments, as represented by the memoranda of April 10 and 15. He said he wanted it understood that he had instructed his company, during the pendency of the present negotiations, not to increase its exports to the United States above the normal rate, and not to permit the exportation of Hiram Walker merchandise to other countries; but he took pains to reiterate his former position, saying with considerable emphasis that his company was not a party to the arrangement proposed by the Canadian Government as represented by Mr. Wrong's memorandum of March 31.

OBSERVATIONS.

The opinion of the Government's conferees continues to be, as before, that neither Seagram's nor Hiram Walker is carrying on the present negotiations in good faith, and that neither company has any intention of making an acceptable offer for the settlement of the Government's cases.

We feel, however, that both United and Consolidated are endeavoring to arrive at a settlement.

GRAVES.
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 2
MAY 1, 1936

Printed for the use of the Committee on Finance
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REVENUE ACT, 1936

FRIDAY, MAY 1, 1936

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to adjournment, 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, Byrd, Lonergan, Black, Gerry, Guffey, Keyes, La Follette, Hastings, and Capper.

The CHAIRMAN. The committee will be in order. All right, Mr. Haas, you may continue from where you left off yesterday.

STATEMENT OF GEORGE C. HAAS, DIRECTOR OF RESEARCH AND STATISTICS, TREASURY DEPARTMENT—Resumed

Mr. Haas. On page 4, I think I will start at the beginning of the paragraph, although I read part of that paragraph yesterday.

I have already pointed out that under the proposed law small corporations—I might say, with regard to small corporations, that at the first stage of my statement I am going to put a footnote to explain what I mean by small corporations; that is, corporations with a small income. I will also indicate there that over short periods of time a corporation with large assets may have a small income, but over any period the value of the assets are based upon income, and what I am concerned with, and what affects my conclusions, is the general picture, even though there may be an exception here now and then.

Senator King. Then you do not draw the line at $10,000?

Mr. Haas. I draw it at $10,000. I mean small-income corporations, but the fact that there are some corporations with large assets that may have a small income during the period does not affect any of my conclusions.

Senator King. There are many corporations with capital stock and assets probably of $1,000,000 or more, but with a heavy liability, and would have no income at all. I have known of many such corporations. In what category would you place them?

Mr. Haas. The great bulk of them fit within my definition. Now, a corporation of that sort that has listed assets, or has assets listed at a certain valuation which total up large, does not mean that if the income continues low those assets will have to be written down so they become a small corporation, regardless of the fact they may own half a county, if they are in a real-estate business, in a livestock business, say. In other words, in the final analysis, from an economic
sense, the size of the corporation over any period is its income, its present income, and its anticipated future income. That is the basis for all valuations.

Senator King. I know of many corporations where the capital stock actually paid in in cash is several million dollars and there has been no income in the past 3 years.

Mr. Haas. That is right.

Senator King. What category would you place those in?

Mr. Haas. I say, for the purpose of my conclusion, it does not make any difference at all about where they are placed. They both fall within my definition. A small corporation is one with a small income.

I would say further in regard to your inquiry, Senator, if that corporation, after a few years, did not come in, it would mean the assets would have to be written down or come off altogether. The fact that they had no current income would mean they would anticipate income in the future.

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. The whole operation of declaring out the year’s profit as dividends and resubscribing all or a portion of such dividends to additional shares of the corporation’s stock, either pro rata or in such proportions as might be mutually agreeable to the shareholders, could be completed in the course of a short stockholders’ meeting.

The other advantage which small corporations, in general, would have over large ones would be in the absolute amount of money which would be available to be resubscribed. It is a good general rule that the principal stockholders in small, struggling, and newly established corporations are men of much smaller total incomes than corporations. If, therefore, such principal stockholders subscribe dividend receipts, less the income tax thereon, the proportion of greater in the case of the average small corporation than in the case which exists because of the differing individual income-tax rates while dividends which fall in the bracket between $10,000 and $12,000, cent, or less than the present corporation taxes, by reason of the between $100,000 and $150,000 will be reduced by only 11 per cent dividend received. The income tax bracket dividend income tax. In other words, a greater proportion of the lower brackets, which fall in the bracket between $10,000 and $12,000, cent, or less than the present corporation taxes, by reason of the income bracket dividend income tax. In other words, a greater proportion of the lower brackets, which fall in the bracket between $10,000 and $12,000, cent, or less than the present corporation taxes.
withholding by the corporation of 30 to 40 percent of each year’s current earnings upon payment of taxes less than the amounts payable under the existing law."

Mr. HAAS. I think it figures out, does it not, Mr. McLeod, fractionally less?

Mr. McLeod. That is correct.

Senator HASTINGS. All right.

Mr. HAAS. For many decades, growing and successful corporations have been able to call upon their stockholders and others for additional capital funds through the offering of rights to the stockholders to subscribe for additional securities. Through the issuance of such rights, any medium-sized or large corporation whose stock is traded in the securities markets may obtain the reinvestment in its business of capital equal to all or any desired proportion of the current earnings that have been distributed in dividends; and, if need be, more.

Let me illustrate: Let us assume a corporation that desired to reinvest in its business its entire earnings of $5 a share, but that nevertheless, decided to pay out the whole amount in dividends in order to avoid all corporate taxation under the proposed law. Such a corporation could easily obtain the reinvestment in its business of this $5 per share by offering to its stockholders rights to purchase additional capital stock well below prevailing market prices. The rights themselves would constitute a valuable marketable instrument which could be sold in the open market by any shareholder who was not disposed to reinvest his dividend check. It is equally apparent, of course, that the amount of money which can be obtained in this way is by no means limited to the amount of the earnings of the corporation, but that any reasonable increase in total capitalization can be effected by this means.

Senator HASTINGS. Mr. Haas, may I inquire whether that would apply to the listed stocks, that argument?

Mr. HAAS. You mean listed on any exchange?

Senator HASTINGS. Yes.

Mr. HAAS. Not necessarily. The fact that they are listed would facilitate it, because the fact that they are listed tends to give the stock a marketability which an unlisted stock does not have, although many stocks traded over the counter would not have any difficulty in doing it.

Senator HASTINGS. Do you happen to know whether it would be necessary for such a corporation to get authority from the Securities Commission before it could offer these rights to the stockholders?

Mr. HAAS. I do not know what that regulation is under.

Senator HASTINGS. What I had in mind was: Suppose a corporation has been losing money for 3 or 4 years, and then suddenly had a good year and paid it all out to its stockholders and tried to persuade them to reinvest it. I should suppose the Securities Commission would have something to say about whether that proposal should be made.

Senator KING. I do not think there is any question about that.

Mr. HAAS. I do not think so, Senator, if they made no misrepresentation and laid all the facts on the table. I am not positive about that.

The CHAIRMAN. Is there any question about it it can be written into the law.

Mr. HAAS. That is right.

Senator BARKLEY. All the law requires is that the issuing of securities must be accompanied by a truthful statement as to the reason for issuing them. The Exchange Commission does not exercise the right of deciding whether the stock shall be issued or whether the capitalization should be increased. Of course, the same is true as to the exchange.

Mr. HAAS. Shall I proceed?

The CHAIRMAN. Yes.

Mr. HAAS. During the period between 1921 and 1930, inclusive, the American Telephone & Telegraph Co. paid regular dividends at the rate of $9 per share, the dividends aggregating about $54 millions during the 10 years. But, during this same 10-year period, the corporation offered rights to purchase additional securities to its stockholders in 1924, 1926, 1928, and 1930, and in the aggregate raised about $50 millions of capital from its stockholders through the sale of such additional securities to them, or about $100,000,000 more than the aggregate dividends paid to them during the period.

Senator HASTINGS. Do you happen to know whether the same company has made any such offer since 1930?

Mr. HAAS. I do not believe so. I am not familiar in detail with their business, but they probably did not have their stock requirement for expansion since that time. You see, we went into the very deep depression at that time.

Senator HASTINGS. I am wondering whether there is anything significant about that.

Mr. HAAS. I do not think they would have any difficulty today, if they needed the money.

Senator HASTINGS. I am wondering whether there is anything significant in the fact that that was done during the prosperous years and none of it was done during the depression.

Mr. HAAS. Well, Senator, I think it is a very significant fact. It is difficult to invest in new business when earnings are going down, to increase the investment in business by plowing earnings back. The only time you can do that is when you are making money. So there is no choice.

Senator HASTINGS. Does not your argument rather prove that your way of getting the funds back into the company in the form of a surplus can happen only in prosperous years and it does not apply to depression years?

Mr. HAAS. In general I would say that is correct, and I would also say that the only time in which you can reinvest earnings in a concern is during periods when earnings are being made, and that is during prosperous periods. In other words, companies can continue to use this method. In general they do it during prosperous periods. In general they invest earnings during prosperous periods, because in depression periods they would not have the earnings to invest.

Senator HASTINGS. Do you know whether the A. T. & T. have continued their regular dividends of $9 per share since 1930?

Mr. HAAS. I think they have.

Senator HASTINGS. Do you happen to know whether they took it out of earnings or out of surplus, or a combination of the two?

Mr. HAAS. I do not know offhand.
Senator Barker. The report released by the A. T. & T. 3 or 4 days ago shows the earnings in 1935, I think, were the largest since 1930.

The Chairman. Suppose in that connection we put in the record the last report of the A. T. & T. so you can answer these questions.

Mr. Haas. That is fine.

Senator Hastings. The last report would not necessarily show it, because that is the prosperous year of 1935.

Senator Barker. I am glad to hear you admit that.

Mr. Haas. The Travelers' Insurance Co. of Hartford, Conn., by successive offerings of rights to shareholders to subscribe to new stock at par in 1908, 1910, 1913, 1916, 1920, 1923, 1926, 1928, and 1929, multiplied its outstanding amount of capital stock 20 times, from 1 to 20 millions.

Senator Hastings. Mr. Chairman, it seems to me that is an illustration showing that it is unreasonable to expect insurance companies like that who have made that amount of money in the operation of their business.

Mr. Haas. It may be objected that the issue of such rights is open only to extremely large corporations or that the practice of issuing them is infrequent. Neither of these objections is true. Using figures compiled by the Commercial and Financial Chronicle, the Bureau of Business Research of the University of Illinois estimated that more than 9,000,000,000 of capital was raised by corporations in 1929 through the offerings of securities to their stockholders. In discussing such stock offerings Dewing, in his Financial Policy of Corporations, a standard work on this subject, says [reading]:

They occurred almost as frequently in 1922 and 1923 as they did in 1926 and 1929.

The April 6, 1936, bulletin of the Standard Statistics Co. lists a number of new issues of medium-sized as well as large, that are raising additional capital funds by the sale of securities to their stockholders. These companies include the Union Bag & Paper Co., the Foster-Wheeler Corporation, the Kalamazoo Stove Co., the Atlantic Refining Co., the Standard Tool Co., the Great Northern Railway Co., the Ferro Enamel Corporation, and the Kinney Airplane & Motor Co. Other corporations that have raised capital through the sale of additional securities to their stockholders during the past several months include the Edward G. Budd Manufacturing Co., the Granite City Steel Co., the Ludlum Steel Co., Spiegel May Stern Co., and the Holland Furnace Co.

Senator Barker. Let me ask you, Mr. Haas, what effect does this process have on the value of securities? For instance, if a corporation plows its earnings back into plant, there is no increase in the stockholders; then if it pays it out in dividends and issues additional stock for the amount that would be plowed in out of earnings, they increase their outstanding stock to that extent; what effect would that have, if any, on the value of the stock?

Mr. Haas. It has the same effect as a stock dividend; but from the point of view of the stockholder, judging the market value of the stock, it is on the other side of it.

Senator Barker. Yes.

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Mr. Haas. When the earnings are left in the corporation, the stock reflects those earnings, because it means a gross investment which belongs to those particular stockholders. Now, if you pass the same earnings out to the stockholders in dividends, the market tends to value those same earnings higher than if they were left in. Now, through stock rights, if the stockholders just turn the earnings back to the corporation again, my off-hand opinion would be that the stock, or that the earnings, would tend to be valued higher than if the earnings were left in the corporation.

In addition to that, the earnings per share of the corporation would increase by the decrease in taxation. In other words, a large corporation, or the average of all corporations, present corporation taxes is about 16 percent, so you would have a 16-percent rise in earnings per share.

Senator Bailey. In your opinion, would the stockholders value the stock more highly in the corporation which declared all of its surplus than they would the stock of a corporation that had the surplus?

Mr. Haas. I would say the stock which paid out its current earnings would be more valuable.

Senator Bailey. How long would it pay out dividends after it dropped the surplus?

Mr. Haas. In this bill, Mr. Senator, if you use the word "surplus", we will have to confine it to this meaning: That it means current earnings. Now, if a corporation pays out its current earnings and, because of its fiscal policy, say, regardless of this bill at the present time, it decides that each year, in order to grow and expand, it has an outlook for a profitable investment in capital of 10 percent, say, in a year.

Senator Bailey. That might be true in the case of a corporation that had a fair value, but that is not true in the case of a corporation that does not have a surplus or has a very small surplus. Is it your contention it would be good business for it to accumulate a surplus and fail to pay it out in dividends?

Mr. Haas. I would say, whether or not it is a good fiscal policy of the corporation to accumulate a surplus or not, I think that would hinge upon this question: By accumulating surplus it means you need more capital to invest in the business.

Senator Bailey. I would not at that point. You may not need more capital to reinvest, but your surplus is an asset to the corporation; it enhances its credit, it relieves it of the necessity of going to the bankers, it has its own money to operate. Is it your theory to cut off the surplus?

Mr. Haas. Mr. Senator, you are speaking of a surplus. Reinvested earnings means that it is a part of the stockholders' equity in a corporation, capital stock representing part of it and surplus representing the other part. It is a liability, and you cannot spend that to help you in any instance, you see.

Senator Bailey. You mean to say you cannot use the surplus in a corporation?

Mr. Haas. Whether you can use it or not depends on what it is invested in.
Senator Bailey. Wait one minute. Let us talk plainly about it. You can use it, and do use it, by spending it. The surplus does not remain in the corporation doing nothing.

Mr. Haas. I see what you are driving at, Mr. Senator. I will try to make myself clear. A surplus accumulated out of earnings just means that earnings have been reinvested in the business—new capital has gone into business. The surplus itself is a liability. It belongs to whoever owns the assets. Now, if the surplus, which is $100,000, say, is invested in a steel plant, it is of some aid to the business, it has certain significance to the business. However, if it is put into Government bonds, if there is a sort of an investment pool, then you have a liquid fund which you can call on, but just the mere fact that you have a surplus indicated on your balance sheet does not indicate, without looking over to see what the condition of your assets is, you cannot tell whether or not one corporation is in a better shape to weather the depression in an emergency than another. I mean, take two corporations, one that each year, instead of leaving it in surplus wrote it up into capital and they carried a fiscal policy where they kept a large proportion of their assets in a liquid condition, and another corporation let the account stand, and suppose they were optimistic about business and said, “We will put it into the plant. We will make 25 percent by putting it into the plant instead of putting it into Government bonds,” and they put it into plant and they had a big surplus, but the assets representing that surplus were in the condition in which they were nonliquid and it was no help to them.

Senator Bailey. You say “nonliquid” if it was an investment in machinery, for instance. To go back to my question, would that enhance the value of the stock in the hands of a stockholder or not?

Mr. Haas. To an expert analyst, no. To the general public there seems to be some magic about the surplus on the other side. To an expert analyst I would say “no.” He does as I attempted to do, he looks over to see what happened to this surplus.

Senator Bailey. As a matter of fact, surplus does not always mean cash in bank?

Mr. Haas. No.

Senator Bailey. And as a matter of fact most people who invest money in stocks do it for the purpose of getting a return in cash.

Mr. Haas. That is right.

Senator Bailey. If a corporation plowed its earnings back into the business always and the stockholders got no dividend, they might, after a while, lose interest in the stock unless the stock was very closely never pay out any dividends, because for different reasons they either if a corporation over a long period of years plowed all of its earnings into business and paid out no dividends it might have a little difficulty selling that stock to the public—is that not right?

Mr. Haas. That is right.

Senator Bailey. While the existence of a surplus is no doubt a valuable asset, superficially speaking, it does not appeal to the average stockholder who invests money in order to get a return only—isn’t that right?

Mr. Haas. That is right.

Senator Bailey. The two things might offset each other in determining the public price of a stock which was sold on the exchanges.

Senator King. May I interrupt right there! Is it not a fact, Mr. Haas, that many persons prefer to join in a policy not to distribute the earnings but to plow them back into the business in order to have it expand, and they regard the increase in value of the stock as more important than the dividend?

Mr. Haas. There is a group of people that is highly interested in that now, because by doing that now, if your income is large enough to get in the high-income bracket, it may be up to the 75-cent bracket to them, they have a great interest in putting it back or saving it, as you might say, because for each dollar they put in they save paying the Government 75 cents.

Senator Bailey. Is not that true largely among corporations where the stock is owned by a very few people and where they are indifferent to dividends, where they have got plenty of money on the outside and they do not have to depend on the dividends of that particular stock for a living?

Mr. Haas. That is right.

Senator Bailey. That does not apply to the great mass of stockholders, however.

Mr. Haas. That is right.

The Chairman. Mr. Haas, in that connection, supposing you have a closely owned corporation that has piled up enormous surpluses, like the Aluminum Corporation, or like others that I might call, a stockholder is not particularly anxious to get the dividend because it would go into the higher prices—in that case is 42.5 percent as a maximum rate high enough to penalize those people or to force distribution of dividends? For instance, they might have to pay 75 percent if they owned a great bulk of the stock, and they would pay 42.5 percent by leaving it in there as a surplus. Would not they, as a choice between the two propositions, leave it in the corporation and pay 42.5 percent rather than distribute?

Mr. Haas. That question, Mr. Senator, was discussed in the Ways and Means Committee somewhat along those lines. There is a provision in the bill in regard to that. Mr. Kent could probably discuss that provision.

Mr. Kent. Section 102.

Mr. Haas. Mr. Kent, would you mind discussing that?

Senator Bailey. As I get your view now, the stockholder’s sense of value of his stock, upon the accumulation of the surplus by a corporation, is based upon magic and not upon reality? It is not reality; it is magic?

Mr. Haas. That is just a part of the stockholder’s equity expressed in another account.

Senator Bailey. The stockholder’s equity is not magic?

Mr. Haas. No.

Senator Bailey. The equity is a reality, is it not?

Mr. Haas. Yes.

Senator George. Mr. Haas, let me ask you one question. You give no significance at all to the surplus shown in the bank statement?

Senator Bailey. That is the magic.

Mr. Haas. Suppose you are a stockholder and you look at an account, what is your equity in the concern? You look at the capital
account and the surplus account, the two of them together; suppose
the bank just increased their capitalization the day before yesterday.
That is the point I am trying to make.

Senator Bailey. How do you increase capitalization?
Mr. Haas. By declaring stock dividends to the stockholders.

Senator Bailey. By issuing stockholders' certificates equal to the
surplus?
Mr. Haas. Yes.

Senator Bailey. But that would be magic.
Mr. Haas. No. I should say the situation stayed just the same.
Some people, laymen, might think, "Well, it would be better to have a
surplus in there."

Senator Connally. Mr. Haas, let me ask you a question. You
differentiated a while ago between the value of the stock on the market,
between those that paid a cash dividend out of current revenues and
those that accumulated it. Now, is not this the reason for that?
People buying stock, if they get a little cash dividend out of the cur-
rent revenues, if they get that right now, that, to their mind, is
worth a little more than an expectancy of a dividend which is not
distributed, which may be dissipated, may be lost, they might make
a bad investment and lose a lot of it, if he gets it right now it gives
him an enhanced value of the certificate; is that not true?
Mr. Haas. That is right.

Senator Connally. Is not that the differentiation?
Mr. Haas. That is the main differentiation.

Senator Hastings. Mr. Haas, I would like to know whether or not
you made any estimate along the line of an illustration that I want
to make. Take a $2,000,000 corporation over a period of 10 years,
and suppose it earned 10 percent of $200,000 for 5 years, but paid
none of it out to its stockholders, it would then have accumulated
$1,000,000, and it paid to the Government each year $32,000 in taxes;
if it assumes at the end of 5 years it incurs its plant, whatever its
business is, by using all of the million-dollar surplus, it will then
have $3,000,000 capital investment; isn't that true?
Mr. Haas. What did they do with the surplus over the 5 years that
they earned it?
Senator Hastings. They just kept it.
Mr. Haas. Just kept it in cash?
Senator Hastings. Yes.
Mr. Haas. You mean in liquid security that they could turn in to
buy plant?
Senator Hastings. Yes. My figures may not be exactly correct.
Suppose at the end of 5 years it spent the million dollars by purchas-
ing new material, giving labor to a lot of people, or what not; it in-
creased the value of its plant by $3,000,000, and it continues to earn
$300,000; its taxes under the present rate will then increase from
$32,000 to $48,000; an increase of $16,000.
Mr. Haas. Yes.

Senator Hastings. I was wondering whether, over a period of 10
years, the first 5 during which time they were accumulating this
dividend and the next 5 when they were making dividends at the
same rate, I was wondering, from the Government's point of view,
stock account. Surplus is a capital account. It is just a technical matter which I was trying to explain.

Senator Gorman. It might be expressed in different ways, but, as a matter of practical business experience, it is a far different thing to actually have a surplus and rely upon your ability to induce stockholders to buy back, to exercise their rights, from going into the market and selling your own securities.

Mr. Haas. It shows, Mr. Senator, if the account is kept intact, if over a period this company has grown out of earnings, that that has something to do with the credit, because it is in the balance sheet.

Senator Gorman. Undoubtedly it has something to do with the credit. You do not need to argue that fact. I know the surplus is not necessary. If this bill does not make the accumulation of a reasonable surplus possible without an undue burden, we think it would be far better to forego it, but I hope that this program may eliminate in a large measure the accumulation of an unreasonable amount of surplus. It just seems to me you ought to start with the premise and make a case on the theory that this does permit a reasonable surplus.

Senator La Follette. As a matter of fact, as I understand it, if a corporation accumulates 30 percent, upon which some testimony was given in executive session to the effect that that was a normal, average amount of accumulation over a 10-year period, they will pay less tax on that than they now pay under the existing law.

The Chairman. That is for corporations over $10,000, and for corporations under $10,000 it was 40 percent.

Mr. Haas. That is right.

The Chairman. Anyway, that is a criticism that was first hurled at the suggestion by the so-called business people, that there ought to be a cushion, and the House has answered that by presenting a cushion. What they want is a reasonable cushion.

Mr. Haas. That is right. Senator King. Do you have that in this bill?

Mr. Haas. Yes; to increase the size of business under this bill means to reinvest your earnings, and in order to reinvest your earnings you put it in surplus. The reason I discuss as much as I do the relation between capital and surplus is this—that many corporations look at the surplus account without examining the assets. They often start a new corporation out with a surplus; Senator King. Is not that to take care of some contingency that may arise?

Mr. Haas. Some State laws make it almost imperative to do that. Senator King. You know some businesses encounter lean years more frequently than others. You cannot standardize business.

Mr. Haas. That is right.

Senator King. I have in mind a mining corporation in my State. It was wisely managed. It anticipated lean years. The ore deposit have a reserve they could not have gone to work, and they would have had to throw their men out of employment. In this particular mine they had reserves of several hundred thousand dollars. When the depression came, instead of discharging their men they kept them at work. They made no money. They exhausted all of their reserves; and then, because their credit had been good, they borrowed $50,000 more; and they saved the city, saved the town, saved hundreds of families. Other corporations that did not have those reserves had to close down. You would not want to adopt a policy that would preclude the cushion or the establishment of a reserve to meet contingencies of that kind, would you?

Mr. Haas. No; the point I was making is that under this bill a corporation would have every facility to reinvest in their business and create a surplus account if it wants to do that. My other discussion as to the relationship between capital and surplus accounts is to show there is no difference between them.

Senator King. Is it not a wrong assumption that reserves are kept by many corporations only for the purpose of evading taxes? Is it not a fact that they keep those reserves in order to meet contingencies and to take care of labor and to avoid an economic collapse in their respective communities? I know that is true with respect to mining companies and others that have many reverses.

Mr. Haas. I am coming to that.

Senator Barry. Let us take the case of a corporation that makes net earnings of $100,000 a year, and it decides to distribute half of it; and that decision is wholly within the province of that corporation; now, if it keeps half of it in its treasury, then it pays the tax under this bill in whatever bracket it falls; that tax is paid; and then the corporation could take the balance of $50,000 that it kept after paying the tax and put it all in surplus; isn't that true?

Mr. Haas. That is right. It could do it that way, and it could go out in the market and get new funds and put it in surplus.

Senator Barry. Oh, yes.

Senator Harring. Will you not follow that little further and find out just what would be left?

Senator Barry. It would be necessary to make a calculation on the bracket in which that $50,000 would come, which, I think, is set out in the table in the bill itself.

Senator Connally. Mr. Haas, let me ask you a question. In answering Senator George you said you agreed with him; and I do, too, that it is desirable that corporations accumulate reasonable surpluses.

Mr. Haas. Reserves, I think Senator George means. We would be using the same terminology.

Senator Connally. Reserves?

Mr. Haas. Yes.

Senator Connally. In other words, a fund over and above the capital account, the ordinary capitalization, for any need that might arise.

Mr. Haas. Yes.

Senator Connally. On the other hand, is it not economically unsound and undesirable, from a social point of view, to have them retain all their surplus, to have the corporation just pile it up and not distribute its dividends and bringing more and more assets within the control of a single entity; is not that harmful to the general welfare, and is not that economically unsound from a broad, liberal standpoint?
Mr. Haas. I think it is; and I will make a statement to that effect later on.

Senator Connally. How is that?

Mr. Haas. I agree with you, Senator, that it is economically unsound.

The Chairman. All right, proceed then, Mr. Haas.

Mr. Haas. In addition to the funds which may thus be raised by all profitable corporations, large and small, through the offering of new stock to their stockholders, large corporations, in particular, will continue to possess, as they always have, access to the organized capital markets for the direct flotation of securities to persons other than their existing security holders, and so will be able to raise such additional funds as they may need through the offering of stocks and bonds for public subscription.

Nevertheless, there are some who argue as if capital funds obtained by direct reinvestment of earnings, and therefore credited to an account called surplus, have a special magic about them that makes them more valuable to a corporation than capital funds obtained through other means. Thus it is contended that corporations with large accumulated surpluses will be in a stronger competitive position than corporations with smaller or no surpluses. This contention does not stand examination. As the members of this committee are well aware, the item of surplus occurs on the liability side of a corporation's balance sheet and does not necessarily represent cash or marketable securities or inventories or any other type of liquid asset. In many cases a corporation is born with a surplus as a result of the expedient of undervaluing its capital stock on its books and calling the rest of its paid-in capital "surplus." In other cases the surplus is the result of giving a large and sometimes fictitious value to such intangible assets as goodwill or patent rights.

Senator Bakley. It says "in other cases." You do not mean "in other words'?

Mr. Haas. "In other cases"; yes. In other cases the surplus is the result of giving a large and sometimes fictitious value to such intangible assets as goodwill or patent rights. In no case, in my opinion, can it be stated that a corporation with an accumulated book surplus is in a better competitive position than another corporation with equal assets and similar liabilities and equally good management that has no book surplus. I am using "surplus" there not in the sense of meaning a reserve. It is a liability on the other side of the balance sheet.

It would thus appear that no corporation, large or small, offering the opportunity of a reasonable profit to capital is more likely to be checked in its legitimate desire for expansion under the proposed tax law than under the present system of corporation taxation.

These considerations apply no less to corporations engaged in fluctuating industries than they do to corporations engaged in stable industries. A corporation in an unstable industry will have the same opportunity that it enjoys now of accumulating capital funds during periods of prosperity, through the sale of securities to its stockholders and others, and of using these funds in such ways as it sees fit as a buffer against periods of depression.
Mr. Haas. Is not this what you are saying as to that activity, Mr. Senator, that you give back the earnings to the stockholders that own the corporation? I mean they are the ones who are the owners, and you ask them, "Will you put it back in the company?" They say, "No." Then is not that the answer? They own the company. It is on the other hand the management of the company said, "We are going to hold it whether you like it or not," that is a different proposition.

Senator Bailey. If that is the answer, then your whole theory falls down, because your theory is the corporation owns the earnings and it is not declaring them to the stockholders in dividends, but if the stockholders own and control the corporation, then to be sure they would get that interest. I do not think you can predicate your conclusion upon that premise. You have got to argue one way or the other.

Mr. Haas. I am using both arguments on the same subject.

Senator Bailey. You use one premise and you reach a conclusion in one case that you can do that and in another case that you cannot do that.

Mr. Haas. The matter of fact is I did not come up here to argue, it was not my intention to argue. I am trying to present some economic facts and state my opinion on them in order to make it clear to the committee.

Senator Bailey. I am not arguing with you, but you make some very flat statements here for this record, and I wanted to test you on the validity and soundness of your statements. I am not engaging in any argument. It just occurred to me that that statement is not correct. You make the statement [reading]:

A corporation in an unstable industry will have the same opportunity that it enjoys now of accumulating capital funds during periods of prosperity, through the sale of securities to its stockholders and others, and of using these funds in such wise as it sees fit as a buffer against periods of depression.

You predicate the whole principle on the capacity of the corporation to sell stock rather than the capacity to save a certain amount from its earnings as a buffer. Now, I am telling you that the corporations in this country have not been in a position to sell any new stock since 1930.

Mr. Haas. That is right, and most of them during the depression could not sell stock, and many of them could not pay blow earnings, either.

Senator Bailey. What would have happened to them if they had not had big surprises to distribute? I understand the Department of Commerce stated that they distributed $27,000,000,000 since 1930 over those surprises!

Mr. Haas. Senator, I challenge that statement. I do not challenge the Department of Commerce figures, but I challenge the use which my statement. I do not mean they cannot do the same thing because we are making a change in the law. I say they have the opportunity. It has been read here that corporations pay out all their dividends and then they can do that if they want to.

Senator Bailey. You are not advocating in the sentence that has obtained additional funds by the sale of rights of stock; all you say is
simply reduce the amount distributed in dividends by the amount of tax. You would still have the $300,000 in the surplus.

Mr. Haas. That is right.

Senator Connally. You would still retain the $300,000 surplus, you would pay the tax out of the remainder, and the balance would go to the dividends: is that correct?

Mr. Haas. That is correct, and even under the present law you could take the 16 percent on the amount you would retain and you would get a higher figure too.

Senator Hastie. That stockholder is entitled to get that in order for the company to maintain what has been described as a normal surplus. Of whatever is retained the Government is taking half of it, I say the stockholders are entitled to get it.

Mr. Haas. I do not think that is true.

Senator La Follette. I do not think that is a statement of fact.

The Chairman. The Government is taking no more than it took before.

Mr. Haas. That is right.

The Chairman. All right, Mr. Haas, you may proceed.

Mr. Haas. It is argued by some that stockholders may be reluctant or even unwilling to reinvest in any given enterprise any large fraction of the earnings distributed to them in dividends. But this argument assumes that corporate management may justly reinvest earnings in a particular enterprise against the desire of the stockholders. In the last analysis, however, the earnings of a corporation belong to its stockholders; and stockholders are entitled to exercise a choice, which, under the present corporate practices they do not always possess, with respect to the disposition of these earnings. Insofar as one effect of the proposed change will be to encourage corporate management to obtain the consent of their stockholders for capital expansion, and to give to stockholders, the real owners of the corporation, a greater control over the disposition of their earnings, this effect is altogether desirable.

Senator Bailey. Let me stop you there. You say [reading]:

It is argued by some that stockholders may be reluctant or even unwilling to reinvest in any given enterprise any large fraction of the earnings distributed to them in dividends.

The theory of this bill is that we squeeze dividends out into the hands of the stockholders in order that they may fall into the higher brackets of the income tax.

Mr. Haas. That is not the theory, Mr. Senator. The theory of this bill is that there is certain income which comes via or through the corporate form of doing business which is not now subjected to taxation as income that flows from individual business, and we now set rates up that if a corporation keeps it in the corporation we get the same rate as if they distributed it. We are not telling them what to do about it.

Senator Bailey. But you are telling me now that you do not contemplate raising the tax on incomes to holders of shares of stock, having them report those incomes in their returns and tax them in higher brackets? That is not at all in contemplation?

Mr. Haas. No; I would say—

Senator Bailey (interrupting). You do not intend to do anything on that. Now, if you do not do anything in regard to that, how would you raise $1,000,000,000?

Mr. Haas. No; I do not think you understand me, Senator.

Senator Bailey. Of course that is the purpose. We have had charts exhibited to us showing exactly how that works under each bracket.

Mr. Haas. Yes; I had something to do with the construction of that chart.

Senator Bailey. They will not have any large proportion of their earnings to invest; they will pay them to the Government in taxes.

Senator Connally. Mr. Haas, in connection with that let me ask you a question. Is it not true that under the present tax law there is a premium or inducement for corporations to hold the surpluses and thereby pay a lesser rate of tax ultimately than they would if it was distributed, and is not the theory of this bill to say to the corporation, “Now, we do not care whether you keep it in surplus or not, that is up to you, but if you keep it in surplus, or if you pay it out, the Government will tax it at the same relative rate”?

Mr. Haas. That is right.

Senator Connally. Leaving it entirely optional with the corporation, because, after all, it belongs to the stockholders; they could put it in the right-hand pocket or the left-hand pocket, but we will not permit them to do the Houdini act and switch it from one pocket to the other and therefore getting a reduced rate of taxation and the Government losing that amount of money. The present tax structure gives a preference to the corporation over the individual engaged in the same business.

Mr. Haas. That is right.

Senator Connally. Because the individual may pay a 50-percent surtax and the corporation in the same line of business will pay 15 percent.

Mr. Haas. That is right. Also that the man with the small income is being penalized if he is entering into a corporate business, because he pays 16 percent tax, whereas the individual income tax he may pay no tax, or some tax less than 16 percent.

Senator Bailey. Have you seen the chart showing what portion would go to small incomes and what portion would go to larger incomes?

Mr. Haas. My staff developed those charts.

Senator Bailey. You are perfectly familiar with the charts?

Mr. Haas. Yes.

Senator Barkley. It is not the concern of this bill to squeeze money out of the corporation treasury into the hands of stockholders, but it is the purpose of this bill that, whether it is squeezed or not, it shall pay a tax.

Mr. Haas. That is right.

Senator Barkley. And if somebody who has not been getting a high rate of dividend gets a larger dividend because of the preference of the corporation to pay it out rather than pay a tax on it, to increase that dividend lifts that man up into the higher tax bracket and he will pay more tax. Nobody disputes that, nobody is trying to conceal that.
Senator La Follette. As I understand it, the preparation of these charts was based on 100 percent distribution of dividends, and it simply throws one aspect of the situation, namely, where the increase would fall in case 100 percent distribution took place. That data has been prepared for the consideration of this committee and it is not to be used as a predicate for the statement that the objective of the bill is to force 100 percent distribution.

Mr. HAAS. That is right, Mr. Senator.

The CHAIRMAN. All right, Mr. Haas, you may proceed.

Senator BAILEY. That is one point. When it gets into a certain bracket, I will not undertake to say which one, 50 percent of that would go for taxes, 50 percent of the income to the stockholders.

Senator CONNALLY. Of that which is retained.

Senator BAILEY. Fifty percent will be paid in taxes under certain brackets.

Mr. HAAS. If you repeat any percentage you might wish, I will have one of the people with me give you the corresponding one.

Senator BAILEY. Now, that being true, 50 percent of it certainly would not be available to reinvest, because it goes to the Government.

Mr. HAAS. I see your point is, that if the dividends go out and are paid to people and the Government takes out a larger proportion of that, to the extent that the Government takes it out or gets more revenue, to that extent there will be less money by those individuals to reinvest in the business.

Senator BAILEY. It would not be a question of the stockholders being reluctant, it would be a question of the stockholders not having the power to reinvest the money because the money has gone into taxes.

Mr. HAAS. That is right.

Senator BLACK. Mr. Haas, that is also true if an individual made a profit and he came in the 50-percent bracket.

Mr. HAAS. That is true.

Senator BLACK. In reality, as I understand what you said, you understood it to be the main purpose of this bill to require the group that owned a large proportion of stock in corporations, where they made a profit in a certain year, to pay a tax the same as though they were not favored by owning that large block of stock in the corporation.

Mr. HAAS. That is right.

Senator BLACK. If I understand it, it is your theory that if a man happens to be fortunate enough to make huge profits in a corporation, he should have taxes imposed upon him the same as any other individual who might not be fortunate enough to own that large block of stock?

Mr. HAAS. Yes; and the ones with a small income, by the same token, would have more money to invest in the particular business as the result.

Senator BLACK. Because by the control being exercised by a small group, as we know it is exercised in every large corporation in America, and sometimes only three men might pass on 100,000 stockholders' rights, under that system that has been operating, that group will control the large number of stockholders can withhold the stock and pay a 15-percent tax even on the profit of the very small investor, while the larger investor might escape the 60-percent tax which other unfortunate citizens would pay who did not happen to be interested in that corporation by owning a large block of stock.

Mr. HAAS. That is right.

Senator CONNALLY. Let me ask you this in regard to your talk about the big stockholders wanting to hold it in the corporation and the little fellows clamoring for dividends under the present system, is it not true under this bill that the corporation would have the greatest liberty, and the stockholders likewise, because when the matter of arriving at how much they would retain as a surplus came up no consideration would actuate them except the absolute business necessity of the corporation, because there would be no reason to hold it, the tax would be the same, and therefore the only reason they would enter into the decision as to how much they would retain as a surplus would be the absolutely economic needs of that corporation?

Mr. HAAS. That is right.

Senator CONNALLY. They will keep just as much as they need. They will distribute all that they do not need. Isn't that the real test as to the accumulation of any surplus?

Mr. HAAS. That is right.

Senator KING. I assume, Mr. Haas, that the purpose of this bill is to increase taxes which are to come from corporations or from stockholders of corporations.

Mr. HAAS. The purpose of the bill, to be absolutely correct, is to increase revenue, and the revenue is coming either from corporations or through stockholders of corporations, because the present tax law allows a tax avoidance, if it is assumed that all income should be taxed equally as represented by the income-tax law.

Senator KING. I am not arguing that. I say this bill is for the purpose of increasing the revenue of the Government, and it is supposed to get that money from corporations and from stockholders of corporations.

Mr. HAAS. That is right.

Senator KING. So it will impose an additional burden, whether rightfully or wrongfully I am not concerned with at the moment, upon corporations and stockholders.

Mr. HAAS. Now, the corporation may pay no tax at all. It means the stockholders of the corporation will be taxed more, some will be taxed more and some will be taxed less.

Senator KING. At any rate, the aggregate taxes collected will be approximately $600,000,000.

Mr. HAAS. Yes; more than they were before.

Senator KING. And you will take that amount from stockholders, or corporations, or both.

Mr. HAAS. That is correct; that is the aggregate addition, and it comes about in this way—that somebody will be taxed more and somebody will be taxed less.

The CHAIRMAN. All right; proceed, Mr. Haas.

Mr. HAAS. I turn now to a third objection that has received considerable publicity.

Senator WALSH. Mr. Chairman, I note the third objection merely deals with the claim made that this bill, if enacted into law, will drive individuals with large incomes into buying tax-exempt securities.
That is not a major feature of this bill, and I suggest it be put into the record and the witness turn to part IV to save time.

The CHAIRMAN. I think that is a good suggestion. If there are any questions to be asked about that, we can call on him to answer those questions.

Senator Walsh, I suggest having that printed in the record and have the witness go to part IV, which is more important.

Senator Loneran. If the witness is in a position to speak for the Treasury Department, I would like to ask him a question on that subject.

Mr. Haas. What is the question?

Senator Loneran. What is the attitude of the Treasury Department on the discontinuance of the tax-exempt securities?

Mr. Haas. The Secretary made a statement to several committees in Congress on that, and he has made recommendations against the discontinuance of it. I would be glad to put his statement in the record with regard to that.

Senator Loneran. I would like to know, because I prepared and filed with the Senate on January 16, 1934, a report on this question of tax-exempt securities, and nothing has been done about it. My understanding has been that the Treasury Department desired that no action be taken on that account of the issues that we authorized from time to time.

Mr. Haas. The Secretary has given his statement to Congress on that, I would be glad to put it in the record.

Senator Loneran. I wish you would.

Senator King. Senator, do you refer to securities issued by State and other political subdivisions or only the Federal securities?

Senator Loneran. The Federal securities.

Mr. Haas. I turn now to a third objection that has received considerable publicity. It is contended by some that if the proposed bill should result in a much larger distribution of corporate earnings, it will simply drive individuals of large incomes into tax-exempt securities in order that they might avoid the individual income surtaxes on their additional dividends; and hence it is contended that the Government will not get the revenue that the Treasury anticipates from the new measure.

On its real merits, this argument would hardly warrant extended discussion for certain obvious reasons.

In the first place, the aggregate amount of tax-exempt income available constitutes only a small fraction of the total amount of corporate income.

In the second place, the larger part of it already goes to individuals subject to the higher surtax rates, who, therefore, would possess little motive for selling their tax-exempt securities to others.

In the third place, further increases in the amount of tax-exempt income, made available by new issues of tax-exempt securities, are not likely to be substantial. It is obvious, moreover, that wealthy individuals who sought to convert their large stock holdings into tax-exempt securities would, in the first place, face the necessity of paying substantial taxes on the capital gains realized by the sale of their present holdings. It is also obvious that large stock holdings give their possessors certain advantages other than dividend income, such as generous salaries and immediate economic power, that they would hesitate to sacrifice. It is likewise clear that any sudden and great enlargement of the demand for tax-exempt securities would go far to drive up their prices and drive down their yield to a point that would counterbalance all or most of the tax advantage of such securities.

Although the real merits of this objection hardly justify more than the remarks that I have just made, I propose, nevertheless, to go into the matter a little more fully because of the great amount of misconception that exists respecting the possibilities of greatly increasing this avenue of tax avoidance.

In the first place, refuge from income taxation by means of tax-exempt securities is very definitely limited by the amount of tax-exempt securities available and by the rates of interest that they pay. The largest source of tax-exempt-security income is that derived from the obligations of States, counties, cities, and so forth. The net aggregate amount of such tax-exempt securities has not changed materially during the past 5 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 $17,500,000,000, and on June 30, 1935, approximately $16,900,000,000. 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. Further, it does not appear that the volume of tax-exempt securities will be increased in the near future at a rate anything like the rate of increase during the twenties.

The Federal Government is not now issuing any long-term obligations exempt from surtaxes. In fact, during the present administration the 3½-per cent Liberty Loan bonds and certain pre-war-bond issues the interest on which was exempt from surtaxes have been refunded in part by bonds lacking the surtax-exemption privilege. The only fully tax-exempt obligation that the Federal Government is issuing to the public at the present time 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 about one-tenth of 1 percent per annum on Treasury bills of 9 months' maturity, and at 1½ to 1¾ percent per annum on 5-year notes. Moreover, much of the larger 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 70 or 75 percent, in the hands of a corporation the exemption is limited to the rate of the corporation income tax, the maximum of which is 15 percent 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 are distributed to the stockholders.

In the last Treasury financing, that of March 15, 1936, holders of maturing notes were offered the option of exchanging these notes for
Regraded Unclassified

and

purposes. During the 5 succeeding years, 1926 to 1930, inclusive, they deducted more than $15,000,000,000 on these accounts before arriving at statutory net income or deficit for tax purposes. During the 3 succeeding years, 1921 to 1924, inclusive, they deducted more than $25,000,000,000 on these accounts, making a total for the 8 years of more than $30,000,000,000. These deductible reserves from taxable income, which have been approximating $5,000,000,000 a year, will be allowed under the House bill as under the present law.

Further, beyond these deductible reserves, the House bill clearly permits the retention by small corporations of approximately 10 percent of each year's current earnings and by large corporations of approximately 30 percent of each year's current earnings as additions to corporate surpluses upon payment of taxes lower in both cases than those that would be paid under the present law.

Despite these facts and the further fact that corporations will remain perfectly free to call upon their stockholders and the capital markets generally for any additional capital that they may require, the proposed change in our system of corporate taxation has been called a tax on thrift and a tax that would prevent the accumulation of needed corporate reserves. In this connection certain critics have attempted to use and to play upon a widespread misapprehension of the nature of corporate surpluses. The implication of their remarks is that corporate surpluses consist of pools of liquid assets, cash and the like, which corporations keep available for use in emergencies. As I have noted before, "surplus" appears on the liability side, not the asset side, of a corporation's balance sheet, and very frequently represents fixed assets such as plant, machinery, or intangible assets such as "good will", patent rights, and so forth, none of which can be "spent" to meet depression needs or to repair damages caused by a flood, or any other emergency. It is not the size of a bookkeeping figure called surplus that determines the ability of a corporation to meet a depression or other contingency, but rather the amount of the total assets of the corporation compared with its obligations, and most particularly the proportion of its assets which it keeps in liquid form. The proposed measure would have no influence whatever upon the form in which a corporation might decide to keep its assets, nor does it limit the total amount of capital that a corporation may acquire. When a corporation withholds current earnings from its stockholders it is obtaining new capital from them, though often without their express consent, no less than when the stockholders employ portions of their dividends to purchase additional securities of the corporation.

There are some who, though admitting the inequities of the existing system of corporation taxes, nevertheless defend it on the ground that the corporate surpluses are thus built up free from surtaxes serve a public function by enabling corporations to maintain employment at a higher level than would otherwise be possible in periods of depression. Now, the most obvious fact bearing on this argument is that it simply did not work, as I shall show in detail shortly, when in 1929 the greatest depression this country has ever experienced came upon us. Not only do we now know that the corporate surpluses accumulated in the twenties were not used to any great extent, in the aggregate, to maintain employment during the depression but we also have some ground for suspecting that the
accumulation of these very corporate surpluses assisted materially in
causing the depression. Thus, it has been argued by very respect-
able economic authority that many of the causes of the depression
were starvation of consumption through the withdrawal of a too large
proportion of our funds for corporate capital expenditure. It is not
quite possible that in many instances, important in the aggregate,
overexpansion of plant capacity was stimulated by a desire of the
controlling stockholders in corporations to reinvest earnings for the
purpose of avoiding the taxes that they would have paid if earnings
were distributed. It is also held by many that one of the vicious
influences contributing to the great stock-market boom of the late
 twenties was the piling up of corporate surpluses. Stock-market
speculation, which had already been stimulated by the mere piling
up of such surpluses, was further stimulated by the volume of surplus
funds poured into brokers' loans by corporations.

But let us examine specifically the contention that these accumu-
lated surpluses were actually used during the depression to main-
tain employment, dividends, and other payments. Large figures are
frequently cited to represent the aggregate losses of corporations
during the depression. 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, suppliers of materials, bondholders, and the like; and that
only their previously accumulated surpluses allowed them to do this
without bankruptcy.

We have been at pains to examine the matter a little further on
the basis of the actual income-tax returns filed by corporations, and
I find that 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 3 years, 1931-33, inclusive, we find that they reported
an aggregate net deficit for this 3-year period, after taxes, of 6.8
billion dollars. We also find, however, that this aggregate net deficit
was arrived at after deducting some 11.2 billion dollars for decrep-
tation, some 761 million dollars for depletion, some 3.7 billion dollars
for bad debts, and some 5.1 billion dollars for loss on the sale of
capital assets; deduction which, in the main, do not represent current
cash outlays made for employment, dividends, and so forth. In
other words, the aggregate net income of corporations before these
valuation deductions, in the worst depression in history, was a little
more than 14 billion dollars, and their cash dividends a little more
than 13 billion dollars. For corporations as a whole, dividends,
wages, and other payments, came out of current receipts, primarily,
and not from accumulated "liquid surpluses." The book surpluses
of corporations were indeed reduced, but they were reduced in the
aggregate, not by actual cash disbursements, but by the writing-down
of assets on the books of the corporations.

It may well be objected that these figures may be deceptive because
they include financial as well as nonfinancial corporations. But the
figures for nonfinancial corporations alone, which include all of our
manufacturing, mining, merchandising, and similar business corpo-
rations, tell the same story. Nonfinancial corporations reported a
net aggregate deficit after taxes for the 3 years, 1931-33, inclusive,
of 3.9 billion dollars. Their net income before valuation deductions,
however, amounted to 11.1 billion dollars, and the dividends paid to
10.6 billion dollars. It is obvious that the previously accumulated
surpluses of nonfinancial corporations, while reduced by valuation
deductions, did not represent liquid resources that were drawn upon,
in the aggregate, to pay wages or dividends. The cash and invest-
ments of all financial corporations submitting balance sheets
amounted to 82.7 billion dollars at the end of 1929; at the end of
1933 they amounted to 33.5 billion dollars.

Senator BLACK. Liquid assets?

Mr. Haas. Liquid assets; yes.

Even if we confine our attention to deficit nonfinancial corpora-
tions—that is, nonfinancial corporations reporting no statutory net
income—we find that valuation deductions, rather than cash-operat-
ing losses, accounted for the largest part of their aggregate net losses
during the depression. During the 3 years, 1931-33, inclusive, the
aggregate net losses after taxes of these nonfinancial corporations
that reported no net income amounted to 12.1 billion dollars; but
9.5 billion dollars of this aggregate deficit, or 78 percent, repre-
"ted valuation deductions, primarily, rather than cash operating
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 income, if any, in other years of the depression.

The figures that I have cited were obtained from the income-tax
returns actually filed by corporations with the Bureau of Internal
Revenue. It should be pointed out that there were other deductions
in the book "surplus" of corporations besides those allowed for income-
tax purposes, and some of these represented cash outlays. I want to
make it clear also that the figures that I have presented for all
corporations, for all nonfinancial corporations, and for deficit non-
financial corporations only, are aggregate figures and are subject to
the limitations of all aggregate and composite data. They are not
necessarily representative of the experience or practices of any par-
cular corporation. It is also true that in many cases corporations
employed a portion of the receipts charged off as valuation items for
necessary replacements of plant and machinery. Finally, I should
point out that 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. Many of them revalue their assets up-
ward during periods of prosperity, thereby creating direct additions
to their surplus accounts, independently of their current income.
Similarly, 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.

Although the accounting methods of corporations vary consider-
ably, such variations do not affect the income and deficit figures
that
I have presented, because the regulations of the Bureau of Internal Revenue, as well as the statutes, lay down substantially uniform rules for the determination of taxable and nontaxable income. The Bureau also receives balance-sheet data in connection with corporation income-tax returns. Only a limited use can be made of these balance-sheet data, because, in contrast to the uniform rules for the determination of taxable income, the Bureau has not prescribed detailed uniform regulations for balance-sheet data. It should also be said that our statistics of income are not strictly comparable from year to year, because of changes in law, in affiliations for consolidated returns, and other factors.

Nevertheless, these limitations of the data obtained from corporation income-tax returns do not impair the general conclusions that I have drawn respecting the character of corporation deficits during the depression and the use made, such as they were, of the accumulated corporate surpluses. It must be emphasized, in contradiction to certain misleading statements that have gained considerable currency, that reductions in book surpluses arising in the fashion in which I have outlined 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 for corporations, as a whole, valuation deductions greatly exceeded the aggregate net losses reported during the depression; second, that valuation deductions, rather than net cash outlays, account for the largest part of the losses reported even by deficit nonfinancial corporations; and third, that corporate surpluses in the aggregate have not been drawn down in fact to maintain employment, dividend payments, and other disbursements during the depression.

In conclusion, I should like to state my conviction that the economic arguments advanced in opposition to the proposed change in corporate taxation rest very largely upon misapprehension and misinterpretation of the facts. While certain of these arguments may appear plausible to some at first blush, they do not withstand analysis. In my opinion, the proposed change in our system of corporate taxation is one that, in addition to its productivity from a revenue standpoint, would improve the character of our economic organization as a whole.

(The tables referred to follow.)

Typical new municipal bond issues, January to March 1936

<table>
<thead>
<tr>
<th>Borrower</th>
<th>Amount</th>
<th>Percent</th>
<th>Average maturity</th>
<th>Average yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>State of California</td>
<td>1,306,000</td>
<td>56.4%</td>
<td>49.9%</td>
<td>2.69%</td>
</tr>
<tr>
<td>State of Mush, South Dakota</td>
<td>733,900</td>
<td>42%</td>
<td>41.8%</td>
<td>4.4%</td>
</tr>
<tr>
<td>Buffalo, N.Y.</td>
<td>1,000,000</td>
<td>50%</td>
<td>37%</td>
<td>3.5%</td>
</tr>
<tr>
<td>Trenton, N.J.</td>
<td>1,000,000</td>
<td>50%</td>
<td>39%</td>
<td>3.5%</td>
</tr>
<tr>
<td>Paris, Ill.</td>
<td>1,000,000</td>
<td>50%</td>
<td>38%</td>
<td>3.5%</td>
</tr>
<tr>
<td>Savannah, Tenn.</td>
<td>1,000,000</td>
<td>50%</td>
<td>38%</td>
<td>3.5%</td>
</tr>
<tr>
<td>Indianapolis, Ind.</td>
<td>1,500,000</td>
<td>50%</td>
<td>38%</td>
<td>3.5%</td>
</tr>
<tr>
<td>Providence, R.I.</td>
<td>1,500,000</td>
<td>50%</td>
<td>38%</td>
<td>3.5%</td>
</tr>
<tr>
<td>New York, N.Y.</td>
<td>1,000,000</td>
<td>50%</td>
<td>38%</td>
<td>3.5%</td>
</tr>
</tbody>
</table>

*1 To original (wholesale) purchaser.*
Senator Bailey. Will you tell me how much the write-down was in the case you were discussing, the write-down of capital assets of corporations?

Mr. Haas. We can get it and put it in the record.

Senator Bailey. It sums up to $15,000,000,000. I was running through your figures. You do not sum them up. Assume that there was a write-down of 10 billions of dollars in corporate structures in this country for the last 3 or 4 years, nevertheless they remained solvent and continued to go on. That is true, is it not?

Mr. Haas. That is right.

Senator Bailey. They could not remain solvent after the write-down, except for the fact that they made the write-down out of accumulated surplus. You could not write it out of capital structure; you have to write it out of surplus.

Mr. Haas. You can write the capital down as well as the other.

Senator Bailey. No; if you write down the capital of a corporation, it becomes insolvent, and anybody can close it up. That is statutory. That is not a question of fact; that is a question of law.

Mr. Haas. Well, I am not making any argument that you should not have any surpluses. I have not made that argument through this hearing.

Senator Bailey. The write-down is not valuable to the commerce of this country insofar as it affects the employment of people. It is not sustained by the argument. I will agree you have got some good facts; but after all, the write-down occurred because all values went down.

Mr. Haas. The plant still stayed there.

Senator Bailey. All values went down.

Mr. Haas. That is right.

Senator Bailey. Now, this write-down occurred without impairing the capital or making the corporations insolvent, and therefore they continued to operate. Suppose they had had no surplus, then the write-down would have broken every one of them and you would have this country filled with receiverships. That is the point.

Mr. Haas. I am not trying to make a point as to how a corporation should organize its capital structure.

Senator Bailey. I am not either.

Mr. Haas. Whether they can withstand the situation that you pointed out is largely contingent upon it.

Senator Bailey. Just tell me how they would have withstood the write-down of $11,000,000 in 3 years if they did not have a surplus to be able to write it down. They would have certainly become insolvent.

Mr. Haas. The point is, Mr. Senator, that I have never, throughout the testimony, tried to put up any case against not building up a surplus. I have tried to prove it could be built up, I have tried to prove it did not employ labor, it did not do these other things.

Senator Bailey. It kept millions of people employed, it kept the industries going and they employed the labor.

Mr. Haas. No; I do not think so.

Senator Bailey. The ability to withstand the write-down prevented the corporation from going into receivership. The law is very simple. If the capital stock of a corporation is impaired then a stockholder can bring an action for receivership.

Mr. Haas. That is a legal point.

Senator Hastings. Mr. Haas, you have made some definite statements here in the last paragraph, or next to the last, in which you say [reading]:

First, if we consolidate the income accounts of all corporations for each of the 3 years, 1931-33, inclusive, we find that they reported an aggregate net deficit for this 3-year period, after taxes, of 6.6 billion dollars.

Did not you have the figures before you when you dictated that statement?

Mr. Haas. These are figures from the income account. Senator Bailey was asking for figures from the balance-sheet account. Those figures are in there in the table in the back.

Senator Hastings. All right.

Senator Connally. Mr. Haas, let me ask you one question. Suppose there were not any corporations at all and that we were doing business as individuals grouped together and pooled our assets in these corporations; is it not the theory of this bill, that if that had been the case, that we would be getting now the same amount of money as we propose to get under this bill?

Mr. Haas. In other words, if there was no corporate form of business and they were all operating as partners and nothing else?

Senator Connally. If everybody under the present law was operating as partnerships or as individuals and we were taxing them
under the existing tax rates we would be getting just as much money—approximately the same amount of money as we propose to get under this bill.

Mr. HAAS. Yes, sir.

Senator CONNALLY. The theory of this bill is that we are not going to allow the device of a corporation to prevent the Government from getting what it would otherwise get if there was not a corporation?

Mr. HAAS. Exactly, Mr. Senator.

Senator HASTINGS. Just a minute. These tables you indicate are from 1931 to 1933. I suppose that is inclusive?

Mr. HAAS. We thought that was the worst period.

Senator HASTINGS. Why did you not include 1934?

Mr. HAAS. In my statement here I tried to be very careful. I pointed out deficiencies in the data. It did not affect my conclusion in this case. I took the figures which I thought were at the bottom of the depression. We would be glad to put in 1934 if you want to. We do not have it right now; it is not available.

Senator BLACK. I want to find out if you have any statement which you have compiled with reference to write-downs, as to the amount of dividends that are paid by the companies during that period compared with the other things and the other items. Have you compiled those figures?

Mr. HAAS. We can get it.

Senator BLACK. Would there be much difficulty in getting it, so that we could find out the amount of it?

Mr. HAAS. Yes; I will get it.

Senator LONERGAN. Mr. Haas, may I ask a question?

Mr. HAAS. Yes, Senator.

Senator LONERGAN. Say corporation "A" owns all of the stock in corporation "B", except the shares to qualify the directors, and corporation "B" pays 15-percent corporate tax, the balance is turned into the treasury of corporation "A"; would corporation "A" under this bill be allowed the deduction of 15 percent?

Mr. HAAS. Mr. Turner will answer that.

Mr. TURNER. What is the question?

Senator LONERGAN. Corporation "A" owns all of the stock in corporation "B", except the shares that are necessary to qualify the directors; corporation "B" pays 15-percent corporate tax, turning over 85 percent to corporation "A". Will corporation "A" again be obliged to pay 15 percent on that 85 percent that it receives from its subsidiary?

Mr. TURNER. You mean under the proposed bill?

Senator LONERGAN. Yes, sir.

Mr. TURNER. It depends on whether or not corporation "A" detains 80 percent and pays 15-percent tax. If corporation "B" pays 15 percent it receives will depend on the percentage that it distributes to its stockholders. If it distributes 100 percent, it will pay a 15-percent tax.

Senator LONERGAN. Notwithstanding the fact that the ownership is the same and that corporation "B" pays 15 percent?

Mr. TURNER. That is right.
Senator Connally. Do you not have a law in Pennsylvania that exempts manufacturers from tax?

Mr. Emond. Yes; we have a law in Pennsylvania for 40 years which exempted capital engaged in manufacturing from the capital-stock tax. That law was changed in 1935, for a 2-year period, so they could have a basis for unemployment-relief taxes. Now, in 1937, when that change expires, I cannot tell what will happen then.

Senator Connally. But still the manufacturers in Pennsylvania have an advantage over most of the manufacturers throughout the United States?

Mr. Emond. Not today.

Senator Connally. Not in this temporary period of 2 years?

Mr. Emond. There was a period when Pennsylvania favored manufacturers, and I hope it will favor them again. I see no objection to that point of view.

Senator Connally. I am not arguing that. I just wanted to know whether that is not the fact.

Senator King. However, the assets were taxable?

Mr. Emond. Yes; the real estate and everything was taxable, but when it came to the capital invested in manufacturing it was exempt from that one tax, the capital-stock tax; not at all from the corporation net income tax.

Now, I would like to say, Mr. Chairman, that our committee has considered this bill with very great care, and we would like to present some thoughts to you with reference to it which are hostile to the new portion of the bill, and I want to give you very frankly the reasons for it, which will be more elaborated on in the printed memorandum.

In the first place we regard this bill as fiscally, from the point of view of the Government, an unsound piece of legislation. Why? Because today the Government is relying very largely upon income taxes, but you have an income-tax law which gives you wide variations in the return to the Government. Now, your income-tax law is different from that of Great Britain in that particular. I have certain figures here which I obtained from my friend, Mr. Parker, whom we regard as the most accurate statistician on this subject in the United States.

The Chairman. And the committee so regards him, too.

Mr. Emond. That is fine, sir. In the 13 years up to and including 1935 the United States collected $21,944,000,000 from income taxes. That is the Federal Government. Great Britain collected $1,662,000,000. The average annual income tax in the United States was $1,662,000,000, and in Great Britain $1,350,000,000.

Now, notice the variations in that same 13-year period. Our lowest income was $7,479,000,000 in 1923, and our highest was $2,410,000,000. In other words, the disparity between the lowest and the highest amounts to 225 percent. That is the variation in the United States.

Now, what was it in Great Britain? Their lowest in that period was $1,412,000,000, in 1923, and their highest was $1,936,000,000, in 1929. Their variation from lowest to highest is 37 percent, and ours is 225 percent.

Senator Connally. In other words, you favor our adoption of the British system?

Mr. Emond. Give me just a moment on that, Senator. I want to explain where that variation is. Our income-tax law has a variable feature in it, and their law does not have that feature in it. They tax income, the annual recurrent gains, what the average man thinks of as income; we tax income, including capital gains and losses, and it is the capital gains and losses which caused all the trouble in these variations in income tax.

Senator Barkley. Are you referring to the corporate tax or the individual tax?

Mr. Emond. This is both. This is all of the income taxes in this period.

The Chairman. In other words, you advocate the elimination of the income-tax law?

Mr. Emond. No, sir; I haven't gotten that far, because that is not before the committee. So you have this variable factor that swings your income up and swings your income down. In certain periods you have a feast and at certain other periods you have famine. I say that is bad fiscally.

Now, you propose to add another feature, namely, by encouraging the distribution of the profits, all the profits, or a very large proportion of the profits. In the good years you will swing up higher and in the bad years you go down lower.

Senator Connally. Do you advocate lessening the tax in times of prosperity and making it higher in periods of hard times?

Mr. Emond. I advocate a taxing system which will give you a more stable basis. That is what I think business requires. I think this business of going up and down by 225 percent in 2 years is absurd. When you have the feast, which encourages overspending on the part of the Government, they have got the money, and when you have got the famine, that is when the people are hard up, then you have got to levy a lot of new taxes in order to make up the deficit. That is not good fiscal organization.

Senator Barkley. In order to have a general level of taxes, so it will be the same in depression times as in times of prosperity, you have got to increase the rate in famines and lower it in feasts.

Mr. Emond. To some degree. They have done it in England. In this particular period we know the English are increasing the income tax. Then also you have lowered certain forms of taxation which are just as stable as the English taxes. Take your tobacco tax. The tobacco tax is the best tax from the point of stability that you have got on the statute books, and it is the lowest tax in the percentage of cost to collect. That is a very remarkable feature.

Senator Barkley. That is the only wartime tax that has never been reduced in times of war.

Mr. Emond. It has lived in times of peace as well as in times of war. I think the tobacco tax has been on ever since the Civil War.

The Chairman. Pennsylvania does not raise much tobacco, does it?

Mr. Emond. Oh, yes; we do, Senator. I beg your pardon. Your fondness is for cigarettes, and mine is for cigars. We raise cigar tobacco, sir.

The Chairman. You raise a lot of tobacco for these stories.

Mr. Emond. Whatever they are they are good and they give comfort to the people.
Senator Bailey. Let me say on behalf of the South Carolina farmers that we do not think the tax is equitable. The United States Government gets $1.09 a pound, and the farmer has great difficulty in getting twenty. The farmer works all the year to produce the tobacco and the Government does nothing except passing laws.

Senator Kinzie. The witness says "equitable" not "equitable."

Mr. Emonson. I mean equitable; I mean table. From the point of view of the Government that makes a good tax; that is, a good fiscal tax.

Senator Bailey. That will result in putting the tobacco growers in the stable, because the price he gets for it does not compare with the price that the Government gets.

Mr. Emonson. I am sorry I brought up the illustration. Now I will get back to my point. We have a situation in which you force out net earnings into diverse use at a more rapid rate than the necessities of business would require. You would have in 1930 and 1931 a very much higher return from the income tax than you have now, and you would have in 1933 and 1934 a very much lower return than you have now, and the result would be that you would accent the difference from the top of the hill to the pit of the valley. That is a bad arrangement.

Senator Bailey. Can you put up a good argument for having a different rate of taxes on the income of an individual from that of a corporation?

Mr. Emonson. I think, sir, that I can set up a good argument. Will you save that question for a moment or two?

Now, I say that is bad fiscally, and I hope I have made my point perfectly clear, namely, you would have no increased tax on dividends at the time when you were having a feast, and you would have an increased tax on dividends just at the time when you are having a famine, and that would result in just the same kind of fiscal chaos that there has been in this country for the last 3 years.

Senator Bailey. What effect would the increase in rate have on intensifying the famine?

Mr. Emonson. It would certainly intensify the famine. What I mean to say is the country is just on the point of recovery, and instead of permitting the corporations to use the money, you make them pay the taxes.

Senator Connally. Are you advocating that we keep the present tax law?

Mr. Emonson. I am advocating that you leave it alone, on the ground that it is too complicated to work under the proposed statute.

Senator Connally. You say you want to leave it alone like it is now?

Mr. Emonson. Yes, Senator Connally. You mean the present tax law?

Senator Connally. Yes.

Mr. Emonson. If you are asking me the question as to whether taxing matters, and I am sure some of the tax lawyers that we have Senator Connally. A minute ago you said you would want to leave it alone.

Mr. Emonson. I say, leave this tax alone.

Senator Connally. Your argument a while ago was that this tax had resulted in high taxes during periods of prosperity and high income and in periods of depression of low income.

Mr. Emonson. I am sorry, Senator, I did not make myself clear. I say this: That you have at present one variable factor that gives you a feast or famine, and you propose to add to that a second variable factor which will accent the feast and accent the famine. That is the reason I am opposed to the second factor. I would like to pass to the first factor, but I recognize that subject is not before you at the present time.

Senator Connally. You are against both factors, so far as you have seen them?

Mr. Emonson. I am against both factors, on general principles of common sense. If an Englishman puts in a $5 piece for a horse race and wins a hundred pounds, that is his good luck; the Government takes nothing out of it.

We have made an artificial definition of income in our laws by adding this question of capital gains and losses, and by adding capital gains and losses we have gotten ourselves into an unfortunate fiscal position in which we have this feast and famine; but I recognize that this is 1933, and you gentlemen have a practical problem before. When the time comes that you will deal with that problem, I hope you will invite me to come down, because I shall be very glad to come down.

Now, on this second proposition, I think forcing out the corporate net earnings into dividends, in my judgment, is very bad, from the point of view of the investor, because it will interfere with the regularity which should characterize an investment.

Now, you have had figures presented to you. I have here certain figures for the Allied Chemical, the American Telephone & Telegraph, the General Electric, United States Steel, Westinghouse Electric & Manufacturing.

One of the Senators asked the question about the American Telephone & Telegraph. For 1935 the net income was $122,000,000. Cash dividends on common and preferred stock, $167,000,000. Now, all of these corporations, in a 10-year period, have maintained dividends. The United States Steel and Westinghouse reduced their dividends somewhat, but they have paid some dividends. All of those corporations for the last 5 years were paying out more in dividends than they were getting in net earnings, but they tried to maintain regularity. When they were accumulating the peak they would be paying heavier taxes, and consequently they would not have the funds with which to make their dividend regular. I insist, from the point of view of the government that wants regularity of income and the point of view of the investor who wants regularity of return, it is better to let those corporations smooth out the peaks and precipices themselves, and do it on a basis that will give them a regularity of return.

I had these figures put in my hands a moment ago by the president of a corporation who is in this room today. Net loss over a 4-year period prior to 1923, $1,000,000. Profits, 1923, $26,000. Profits, 1924, $40,000. Profits, 1925, $100,000. That is $100,000 of profit made possible by increased sales. This is a retail store. But in order to
carry on that business with the increased sales they had or increase
their inventory by $100,000. That was the development of new lines.
They had to increase their accounts receivable by $75,000. That was
in order to carry the new accounts. They had to make improvements
in the store and in the delivery service of $15,000. So to get that 3
years' profit required an outlay of $190,000 from their working
capital. In other words, they had to borrow money as well as use all
their profits.

Now, that is the condition of many businesses today. I have in
mind particularly the small business. They have the idea that they
will eventually grow and grow. Many of you gentlemen have prac-
ticed law, and you have seen in your practice cases of small busi-
nesses, how the man works, saves, and plows the money back, and
eventually gets the big business. It seems to me the opportunity to
do that sort of thing ought still to be left to the people of America
without putting too high a tax on them, if they are willing to go
through the sacrifices that are necessary to build up the business.

Now, my second point is that this up-and-down business is bad for
the investor, and it would be bad in the long run for the character
of the American people. It is better to have these corporations with
a surplus that will give a regularity of dividend and a regularity of
return, even though they accumulate a surplus in order to carry it on,
rather than taking it away from them in taxes.

The Chairman. You haven't the figures there of the Gulf Refining
Co., have you?

Mr. Edmonds. No; I have not, sir.

The Chairman. Have you the figures there of the Aluminum Co.?

Mr. Edmonds. No.

The Chairman. You do not know how much in the way of divid-
ends they paid out in the last 10 years?

Mr. Edmonds. I have no knowledge of the Aluminum Co. I have
seen a reference to it in the House at some time.

Senator Bailey. I think I saw in the paper, in the New York
Times a few weeks ago, that on last year's earnings they paid about
$8 a share.

Mr. Edmonds. I think, Senator, you ought to consider this: If you
attempt to make laws for the United States with the view of catching
one or two particular corporations, you will make foolish laws.

The Chairman. We are not trying to catch just some of the cor-
porations; we are trying to make uniform laws, so that certain insti-
tutions will not allow all their earnings to be piled up to the disad-
vantange and inequalities of the entire situation.

Mr. Edmonds. You made some amendment a year ago, or 2 years
ago, to the taxing bill, with reference to personal holding companies
methods that you already have are what you ought to use for excep-
tional cases rather than change the law for us all.

I have here an article from the New York Times by Henry Hazlitt,
who has some figures that I think are pertinent, and I will supply it
for the record. I will not read it for the particular years.

The Chairman. You may put that in the record.

(The article referred to is as follows:)}
average shows something like $200,000,000 per year distributed more than their net earnings in that period, and that shows how the tendency is to equalize the feast-and-famine proposition by wisely managed corporations.

Senator Bailey. And to maintain the constant buying power.

Mr. Edmonson. Yes; to maintain the constant buying power and employment. Let me speak on the third proposition.

Senator Bailey. Let me ask you a question first.

Mr. Edmonson. Here is my third point: I want to ask you gentlemen if you have considered fully the relationship of this kind of tax to unemployment. I understand the tax bills are designed to raise revenue. That ought to be their primary object, and their primary object must be their most important object.

The Chairman. That is so stated in the bill.

Mr. Edmonson. Every thinking man must give consideration to the fact that in this country there are millions out of work. How are these millions going to be put back to work again?

I am very glad to say personally I have my own philosophy on the subject. While I haven't introduced myself to you at the beginning of my address, I will say that I was chairman of the Pennsylvania Tax Commission from 1924 to 1927. That is not a commission like the one that Mr. Stone presides over in Mississippi, it was not administered to increase the revenue from taxes, it was to reduce the revenue, like I said to the chairman of the Ways and Means Committee. I was on the uniformity and reciprocity committee of the State Tax Association. I was president of the National Tax Association in 1932 and 1933. So at any rate I have given some little thought on this subject.

It is my very clear feeling that we would go out of the depression only by encouraging new industries. It is the new industries that must take up the slack of unemployment. How can they do that? In our report we give you a special illustration of the Budd Co. of Philadelphia. Edward B. Budd is a man who is a genius in dealing with metals. He started 30 years ago making automobile tops, and he has a pretty large business along that line. For the last 5 or 6 years he has paid no dividend. They have spent 6 years in experimenting with stainless steel. They did not invent stainless steel, but they did fabricate it, and they were the first company that was able to fabricate it. They spent a million and a half of their accumulated net earnings in trying to solve that problem. And what have they done? They have given a new industry to the United States today, the making of zephyr trains on the western plains, for which the order is stainless steel for. The Federal Government has required some of this stainless steel fabrication for the superstructure of the war vessel, that will increase employment possibly to 1,100 before the end of the calendar year.

Now, frankly, that is the way in which you get out of the depressions. Remember that every one of those 1,100 is probably, in Mr. Budd's case, the head of a family.

Remember also what Colonel Ayres proved so conclusively in his figures—that every time you give employment to a thousand men in

the productive line you give employment to about 900 more in the servicing lines that are made necessary for the thousand that are employed in that special position. The consequence is that when it gives an additional employment to 1,100 men you have practically 2,000 men that are removed from the relief rolls at once.

Now, frankly, it seems to me that the United States ought to encourage those new industries, and I want to say that there is no factor that has done so much for developing new ideas as the research departments that have been built up in the corporations with their surpluses. That, in my mind, is the great feature, so far as the life's blood of our Nation is concerned.

We do not continue in this country in a static way. We are a dynamic people. We advance. If a man does anything this year in one way, he wants to do it better next year, whether it is automobile, railroad, textile manufacture, or whatever it may be. It is that improvement that requires capital.

Now, how are you going to provide the capital if the whole pressure of the Government is put upon having net incomes paid out as rapidly as possible?

Now, I submit to you, gentlemen, that from the point of view of the Nation, looking at it from the point of view of getting ourselves out of the situation that we are in now, I say that any possible encouragement that is given to this experimentation is the thing that will eventually lead us into the list of new occupations that will take up our slack. I could tell you a lot more about that if you would like to hear it.

Senator Barkley. I have no doubt of your sincerity and your earnestness in what you said. I appreciate it. You made some very interesting statements about what we ought not to do in order to raise this additional revenue which we must have. Have you any suggestion as to what we ought to do in order to raise it?

Mr. Edmonson. I will tell you very frankly what you ought to do, sir. You want to raise $700,000,000. Cut down expenses by $700,000,000 and you are in just the same position. That is the only answer business can make to you. We say in here that the Federal Government ought to devote itself to its ordinary program. That, I imagine, would be $4,000,000,000, and it ought to provide money for unemployment relief, because the State and the local government cannot take hold of it in this magnitude at the present time. Let us say that would be $5,000,000,000, maybe $5 1/2 million if you include the C. C. C.'s, etc. If you cut down the expense of $5 1/2 billion dollars, business would be only too glad to sit down with you, because then we would be on a stable basis.

Senator Barkley. This additional income is made necessary because of the passage of the bonus bill, which is now an accomplished fact, and because of the decision of the Supreme Court in nullifying the processing tax as a part of the agricultural program.

Mr. Edmonson. In other words, it is made necessary by the legislation of Congress.

Senator Barkley. Well, the legislation was necessary because we could not have a genuine prosperity in this country unless agriculture shares in it, and although for 10 years you have been boasting of artificial prosperity in other classes, everybody knows the condition of the farmer had been growing more serious all the time.
Mr. Emmons. If you will make a bargain with me—I will say if you will not put on me the sins of my party, I will not put on you the sins of your party.

Senator Banker. I am not putting on you the sins of any party.

Mr. Emmons. You talked of my 10 years' boast.

Senator Banker. I am speaking to you not in an individual way. It was the boast of business in the whole country. They are opposed to any legislation that is designed artificially to remedy a situation that was created artificially. Now, whether we were wise in the passage of the Agricultural Adjustment Act or not, it increased the farmers' income over $3,000,000,000 a year. It enabled him to begin paying his debts and to buy some of the things that your factories produce. You may or may not agree with that program, but it was adopted, and it is the only one that has been adopted in 20 years that worked, although the Supreme Court held it unconstitutional, which they did way back in 1890, when we passed an income-tax law, and which they have done some 65 times since the Government was organized in 1787. So there is nothing peculiar about the fact that the Supreme Court declared that particular law unconstitutional and declared one or two others unconstitutional.

Mr. Emmons. Don't forget that for the income tax we amended the Constitution. Why do you not amend the Constitution for the AAA?

Senator Banker. We haven't had time. I do not know that it is necessary. Personally, I hope it will not be necessary; but we are talking about a condition now produced by the effort of the American Congress to stimulate agriculture and to stimulate industry, too. You will admit that it was an artificial stimulation, but it was an artificial condition that brought about the necessity for stimulation.

Now, we have got this condition here. We have got to get some money. The question is: Where are we going to get it? If you have got any idea as to where we are going to get it, I would like to have it. It is not an answer to say that we must pay the expenses by reducing the expenses in some other branch of the Government in the amount of some seven or eight million dollars.

Mr. Emmons. I was giving you an answer that our committee gives out, and it says very frankly that it is the demand of business that we save this money by cutting down expenses. Now, let me give you my personal answer. I think we are tied to the cross, and it is a very sad condition that we are in. I think that you gentlemen have sometimes lost sight of the fact that you are not supposed to the Federal Government to spend about 3½ billion dollars, and that I think you have got the Federal Government spending about impoverishing the assets on which local governments are going to support themselves.

Senator Banker. We have to do that, because the local governments came to Washington and laid their burdens on the doorstep of Uncle Sam. They said, "We have exhausted our resources, we have exhausted our taxing ability. We cannot borrow any more money." Therefore, Uncle Sam had to assume the burden. We had to assume it or allow millions of people to starve or freeze. We did not assume the burden because we want to do it; I would be glad to get out from under it tomorrow, so far as the whole program of Uncle Sam is concerned, if we could do it, but we cannot.

Mr. Emmons. I am willing to agree that no man will put his head in the noose willingly.

The Chairman. Your time has expired, but if you want to extend it by adding anything else you may do so.

Senator George. I want to ask one question with reference to the bill. Assuming that under this bill a corporation may accumulate reserves, on the aggregate, of approximately 30 percent of their annual net earnings without a corporate-tax outlay, which is more than under existing law, what have you to say on that point?

Mr. Emmons. My point is it loses sight altogether of the corporations that ought to accumulate all their earnings.

Senator George. I understand that you take the position they should be allowed to accumulate all their earnings.

Mr. Emmons. Yes.

Senator George. On the average, would that not give you a fair, healthy corporate structure?

Mr. Emmons. I do not think, personally, that it would. I think it would be an encouragement to established business that has its surplus before January 1, 1935, and it would be a terrible discouragement to the young man who is starting out in business with little capital.

Senator George. We cannot go back and remedy that.

Mr. Emmons. You cannot tax him back, but you can lift the young man out by putting him in such a position that he only pays as much as competitive businesses do.

Senator George. The point I am asking you, would you say, as a student of the subject, with practical experience and dealing with practical affairs, would you say that the leeway there, the possibility of retaining approximately 30 percent of the annual earnings, would not give a necessary reserve to the prudent corporation, assuming the policy of setting aside such part of it as might be necessary?

Mr. Emmons. No, Senator. Let me give you an illustration. I incorporated 6 months ago a hardware business for $10,000. Practically all the stock is owned by a man who started in business 10 years ago. He is saving up the surplus. He is buying a house for himself and he wants to separate his corporate investment from his personal investment. That man will have to plow all of his earnings into that business for at least 5 or 10 years before it becomes a healthy business that can compete with the other businesses in the community. It is that man that you are hurting.

Senator George. I understand that. He has got some competitive disadvantage by the fact that he cannot plow all of his earnings back, but would it not develop, over a reasonable period of years, a fairly strong, healthy corporate structure? Would that not make it possible?

Mr. Emmons. To that question my answer is "No." I think you would discourage tremendously new business, and you would dis-
encourage the small businesses that grow into the big businesses that seem to be worthy of encouragement.

Senator La Follette: Under the illustration you gave the fact is that under this bill that corporation would retain 40 percent, is that true?

Mr. Emonds: I think that is true. It is 40 or 39 percent. That, by the way, is the last point that I wanted to touch on. May I say, Senator, I have a very high regard for the Senate of the United States. I hope very much, when you frame a tax bill that you will frame it in understandable English. My feeling is that the bill you have got before you now does not contain understandable English for the average man. Now, I have read it, I have gone over it with my partners, and it is quite clear to me that you cannot understand it except by taking a practical illustration and working it out.

The CHAIRMAN: We hope you will understand it when we finish it.

Mr. Emonds: That will be fine.

Senator King: What would you think of a proposition to increase the corporate taxes in four categories—15 percent, 16 percent, 17 percent, 18 percent in the highest, and then increase the income taxes upon individuals, increase the surtaxes from 4 to 5 percent, and then increase the surtaxes on income in the higher brackets to raise about 8 or 9 hundred millions of dollars, in comparison with the present bill?

Mr. Emonds: It is better than the present bill. The point of view of our chamber of commerce is you ought to cut down Government expenses; but it is better, because it is equitable under a general law, and you do not throw on the little man the burden of employing an accountant or attorney. This bill ought to be clear. It requires an accountant in computing tax matters. I am representing the chamber of commerce, which is on a little higher plane, but I say very frankly you ought to have something here so that the average man can know what you are for.

Senator Black: Are you an attorney?

Mr. Emonds: Yes; I am an attorney.

Senator Black: What is the name of your firm?

Mr. Emonds: Edmonds, Obermayer & Rehmann, in Philadelphia.

(The report referred to by Mr. Emonds is as follows:)

REPORT OF COMMITTEE ON TAXATION AND PUBLIC EXPENDITURES

PHILADELPHIA CHAMBER OF COMMERCE.

April 18, 1928.

To the Board of Directors, Philadelphia Chamber of Commerce:
The committee on taxation and public expenditures respectfully submit the following report:

From the point of view of taxation, every citizen is subject to three authorities, viz., the Federal, State, and local governments. During the period of the depression additional duties have been assumed by each of these governments, and as a result they have been obliged to raise additional funds. In some cases by taxation, in other cases by selling bonds, and each branch of government has led to the raising of money by any device that the tax system has become unstable, uncertain, and unnecessarily complicated. At present the Federal Government is considering a new revenue measure estimated to produce from $600,000,000 to $900,000,000. The State government has announced that there will be a special meeting of the general assembly to provide additional revenue for relief. Under these circumstances it is the duty of all citizens to consider the general subject and to give their best advice to their representatives. Consequently we outline here the courses of action which we are prepared to recommend to our representatives in Congress and in the general assembly of the State.

1. GENERAL PRINCIPLE

It is an often-quoted general principle that ordinarily the budgets of government must be balanced and that the current yearly income must equal the current yearly output. In a time of economic strain it is essential that the representatives should always have the worst before they provide the income. On the part of the Federal Government we would like to see a careful scrutiny of expenses, eliminating every extraordinary expense on the Federal budget except the provision for the support of the unemployed, which at the present time is too great to be provided by State or local finances exclusively. Every other form of expenditure except the ordinary program of government should be brought to a termination as speedily as possible and the budget made up on this basis.

Until this is done the business interests of the country are compelled in self-defense to record their opposition to all new forms of taxation. When expenditures have been reduced to a minimum the business interests of the country should cooperate in suggesting methods of raising revenue to the end that budgets may be balanced and a stable fiscal condition result. But it is useless to expect these suggestions from business until the work of economy has been done or a program for its accomplishment adopted.

2. FEDERAL GOVERNMENT

There is now pending in the Congress of the United States a proposition which is expressed in the report of a subcommittee of the Committee on Ways and Means of the House of Representatives, but which at the time of the preparation of this report has not yet been reduced to the form of a bill. In principle it is proposed to abolish the Federal corporation income and capital-stock taxes and to substitute, therefor a graduated tax upon the net earnings of corporations, the rate increasing with the proportion of net earnings that shall be attained after January 1, 1929, but not distributed as dividends to stockholders. It is furthermore proposed to extend the normal personal tax to corporations so as to apply the same to the dividends which taxpaying corporations receive. It is claimed that these proposals will result in a reduction in the taxes paid by corporations to the Federal Government, but in an increase in the returns of the personal net income tax to so great a degree as to provide for the losses resulting from the reduction in corporation taxes, with a net additional revenue in excess of $500,000,000.

The proposal for a graduated tax on net earnings of corporations not distributed as dividends is not new. It was considered in Congress in 1921 and in later years, and it has frequently been advocated by those whose point of view has been fastened upon the relatively few corporations, some of which are more or less personally controlled and which by accumulating net earnings save to their stockholders the burden of paying personal income tax upon dividends which might otherwise be declared. It is to be noted that under existing law, sections 102 and 331 (the latter enacted in 1904), provide a present method of taxing undistributed corporate surpluses. The advocates of this principle contend that if an individual makes money he pays personal income tax upon dividends which might otherwise be declared. It is to be noted that under existing law, sections 102 and 331 (the latter enacted in 1904), provide a present method of taxing undistributed corporate surpluses. The advocates of this principle contend that if an individual makes money he pays personal income tax upon dividends which might otherwise be declared. It is to be noted that under existing law, sections 102 and 331 (the latter enacted in 1904), provide a present method of taxing undistributed corporate surpluses. The advocates of this principle contend that if an individual makes money he pays personal income tax upon dividends which might otherwise be declared. It is to be noted that under existing law, sections 102 and 331 (the latter enacted in 1904), provide a present method of taxing undistributed corporate surpluses. The advocates of this principle contend that if an individual makes money he pays personal income tax upon dividends which might otherwise be declared. It is to be noted that under existing law, sections 102 and 331 (the latter enacted in 1904), provide a present method of taxing undistributed corporate surpluses. The advocates of this principle contend that if an individual makes money he pays personal income tax upon dividends which might otherwise be declared. It is to be noted that under existing law, sections 102 and 331 (the latter enacted in 1904), provide a present method of taxing undistributed corporate surpluses. The advocates of this principle contend that if an individual makes money he pays personal income tax upon dividends which might otherwise be declared. It is to be noted that under existing law, sections 102 and 331 (the latter enacted in 1904), provide a present method of taxing undistributed corporate surpluses. The advocates of this principle contend that if an individual makes money he pays personal income tax upon dividends which might otherwise be declared. It is to be noted that under existing law, sections 102 and 331 (the latter enacted in 1904), provide a present method of taxing undistributed corporate surpluses.
(d) The proposal leaves aside altogether the great issue which has been made by many industrial corporations in the building up of business and plan through the wise use of surpluses. The experience of the Ford Motor Co., which today represents an investment out of earnings of $70,000,000 and gives employment directly to 20,000 men and indirectly to thousands additional from an original investment of $40,000, is an illustration of this principle. We are convinced that the way out of the depression is through the development of new ideas, and that nothing is so conducive to such a development as the wise use of corporation earnings in research, analysis, and experiment in order that new ideas may be prepared for the market. As an illustration of what can be done along these lines, we refer to the example of the Budd Co. in Philadelphia, which spent more than one and one half million dollars from its surplus and 5 years in development upon a new product which could be developed. As a result this branch of the Budd Co. is today employing 600 men who were not employed 2 years ago and has already received orders which will require 1,500 employees in this department. If a substantial fraction of the 4,500 men presently employed in the plant. This company affords an excellent illustration of the way in which unemploymen can be relieved through the development of new ideas.

In a general way, the English promote new ideas by the sale of stock, but this plan is not always adopted even in the United States. We believe that it would be difficult to finance new ideas in America by the sale of stock to any degree. Industrially speaking, our country is dynamic and not static. We expect improvements in process and ideas, and these improvements have been developed in large measure through the practice of putting back into the industry earnings of our businesses, resulting in larger plants, greater facilities, new ideas, and additional employment. It will be a matter of high degree if the public is convinced that the author can do this in a practical way.

(e) It is to be noted that the suggestion contained in the report of the subcommittee will not result in balancing the Budget. The income is not distributed as dividends until after the close of the year. It is apparent, therefore, that this taxing plan is not based upon any idea of bringing the Budget into prompt balance.

(f) For all of these reasons we submit that the plan of taxation now under consideration will work an economic hardship on the American people, delaying the period of recovery which is so profoundly desired.
on January 6, 1926, the city was directed to pay forthwith to the sinking funds the sum of $2,687,613.04 for the requirements of 1925. But $1,000,000 has thus far been provided, and we recommend to city council to formulate at once a plan for this payment, and to this end to inaugurate a policy of strict economy in the municipal business.

V. CONCLUSION

We realized our representatives that it is probable that at present 20 percent of the gross income of our people is being used for the expenses of government. If we included the entire expenditures of government, including loans for current expenses, we would be obliged to say that the total outlay of government in the United States at the present time represents more than 30 percent of the gross income of the people. It is impossible to expect that business will expand so as to take up the slack in unemployment so long as this condition exists. Business needs stability in taxation in order that plans may be formed for the future, and such plans are essential in order that unemployment may be reduced to a minimum.

We present these suggestions in the strong hope that the point of view here presented may meet with the approval of our legislators and thereby pave the way for a restoration of prosperity.

Respectfully submitted.

Memorandum from: Philadelphia Chamber of Commerce.
Prepared by: Mr. Sydney P. Clark.

The conclusions and recommendations contained in the report of the subcommittee on serial bonds of the committee on taxation and public expenditures of the Philadelphia Chamber of Commerce, dated January 27, hold true today. We are, therefore, outlining in this memorandum the practices followed by certain municipalities in the United States and in the State of Pennsylvania, other than the city of Philadelphia, with regard to the issuance of municipal bonds in either term or serial form. For purposes of comparison throughout the United States we feel that an examination of the form of debt outstanding in each of the first 10 cities of the country will serve to indicate the general practices and trend. The first 10 cities of the United States in population are as follows: New York City, N. Y.; Chicago, Ill.; Philadelphia, Pa.; Detroit, Mich.; Los Angeles, Calif.; Cleveland, Ohio; St. Louis, Mo.; Baltimore, Md.; Boston, Mass.; and Pittsburgh, Pa.

New York City, N. Y., population 1930 census, 6,930,446

The city of New York utilizes both forms of municipal bonds—sinking fund and serial. The sinking fund, or term bonds, are known as 'corporate stock' and mature within 50 years after date of issue. Corporate stock usually is issued to finance the cost of capital improvements of a revenue-producing character, such as water, rapid-transit and dock properties. Serial bonds are issued for the purpose of financing capital improvements, and the final maturity must not exceed the life of the improvement financed, and the maximum maturity in any case must not exceed 50 years. As of January 1, 1926, the city had outstanding corporate stock in the amount of approximately $1,230,000,000 par value, and serial bonds in the amount of approximately $442,000,000 par value.

Chicago, Ill., population 1930 census, 3,776,448

The city of Chicago had outstanding in December 1925 approximately $208,000,000 par-value serial bonds, and approximately $2,000,000,000 sinking-fund bonds. The sinking-fund bonds were issued in 1920 and 1935 for refunding purposes.

Philadelphia, Pa., population 1930 census, 1,759,961

In December 1925 the city of Philadelphia had outstanding approximately $300,000,000 par-value bonds, all of the sinking-fund type.
The city of Scranton has a total of $225,000 in term bonds, all issued in 1916. The balance of approximately $7,500,000 in term bonds are all in serial form.

Scranton, Pa., population 1930 census, 144,433

All of the bond issues of the city of Scranton are in serial form.

The city of Erie has a total of $250,000 in term bonds, all issued in 1916. The balance of approximately $7,500,000 in term bonds are all in serial form.

Erie, Pa., population, 1930 census, 144,433

The city of Wilkes-Barre has a total of approximately $250,000 in par value of term bonds, all issued in 1912 and 1913. The balance of approximately $6,750,000 in par value of bonds are all in serial form.

Wilkes-Barre, Pa., population, 1930 census, 86,436

All of the outstanding bonds of the city of Scranton are in serial form.

Allentown, Pa., population, 1930 census, 88,562

The city of Allentown has approximately $2,400,000 in par value of term bonds and approximately $2,900,000 in par value of sinking-fund bonds. No sinking-fund bonds have been issued by the city of Allentown subsequent to 1929.

Allentown, Pa., population, 1930 census, 88,562

The city of Altoona has approximately $1,500,000 in par value of serial bonds and approximately $3,200,000 in par value of sinking-fund bonds.

Altoona, Pa., population, 1930 census, 84,839

All of the outstanding bonds of the city of Altoona are in serial form.

Harrisburg, Pa., population, 1930 census, 87,003

The city of Harrisburg has approximately $1,000,000 in par value of term bonds, dated 1922 or prior thereto, and approximately $3,300,000 in par value of serial bonds. Without going further into the division between sinking-fund and serial bonds in other individual cities, it is true that in Pennsylvania and throughout the United States as a whole the sinking-fund issue is the exception and the serial issue the rule.

Practice of nine largest cities in the United States as to issuance of sinking-fund or serial bonds

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<tr>
<th>City</th>
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1 All bonds.

The above figures are subject to comments in the attached report.
Senator La Follette. You do not think, do you, that the stockholders have any right to any earnings?

Mr. Seward. I certainly do. I think it has been demonstrated this morning that the stockholders have received earnings to pay an excess-profits tax.

Senator Black. Do you think it is an outrage for an individual to pay 72.9 percent if he makes that much profit?

Mr. Seward. I certainly do.

Senator Black. So you are opposed to the income tax in the high brackets?

Mr. Seward. I think it defeats itself.

Senator La Follette. This is one of the loopholes we want to plug up so it will not defeat itself.

Mr. Seward. Gentlemen, may I have the privilege of making the statement completely, and then I will be delighted to answer the different questions?

Senator Black. Did you place in the record your business?

Mr. Seward. I am a certified public accountant.

Senator Black. You appear in your own capacity?

Mr. Seward. I appear as the chairman of the tax committee of the New York Board of Trade, and not in my individual capacity at all.

Senator Black. Are you employed by them or simply representing them voluntarily?

Mr. Seward. I am chairman of their tax committee and a member of their executive committee and a member of the board of directors.

Senator Black. You are not employed by them?

Mr. Seward. I am not employed by them.

Senator Barkley. Are you a member of a firm of certified public accountants?

Mr. Seward. Yes, sir.

Senator Barkley. What is that firm?

Mr. Seward. Seward & Seward, New York City.

Gentlemen, there is just one thing definitely known about the proposed bill. It will abandon an assured revenue totaling $1,132,000,000, in exchange for something which is highly speculative and entirely conjectural in its revenue-producing possibilities.

The theory of a corporate undistributed profits tax has been discussed from time to time for many years. Never in this country, however, and seldom anywhere else, has this theory been put to the test of real practical experience. As against this, our present system of taxing corporate profits and dividends is one which has taken us almost a quarter of a century to evolve. It has been perfected by thousands of rulings and judicial interpretations. At a time spending so much more than what we are recuperating from the worst depression in our history, and when possibly we must afford to gamble such a vast sum of known public revenue, it is so much an adventure into the wilderness?

Much criticism has been directed against the basic theory of the undistributed-profits tax. I believe that many of such objections can be overcome by a carefully thought-out bill. Such a bill, however, cannot be born in haste, at, in fact, the bill before us has been. In my opinion, this subject cannot possibly be dealt with adequately by the present Congress during an election year. I will, nevertheless, direct my remarks to some of the specific provisions of the bill, on the assumption that this Congress is going to enact an undistributed-profits tax and that we might just as well get the best possible bill under the circumstances.

In directing my criticism to this proposed bill, you gentlemen may be interested to know that I am not antagonistic to the theory of an undistributed-profits tax. As a theory, there is much to commend it. But for the plan to have a chance for a successful career, it must be initiated under conditions very much more favorable than those existing today. It must also be entered into with the clear understanding that the plan is a highly experimental venture and that it will call for some very delicate adjustments in our economics in the process of shifting from one method of taxation to the other.

In any event, the plan will be doomed to failure, and to be the cause of some serious dislocations, if it attempts to penalize corporations too severely for the privilege of retaining necessary working capital and reasonable reserves. Likewise is it bound to meet with failure if tax rates imposed upon the income of individual stockholders are so high as to discourage the continuance of investment in productive enterprises. As long as tax-exempt securities are available to investors having large taxable incomes, any scheme calculated to force corporations to distribute earnings for the sole purpose of adding to the stockholders' taxable incomes means so much additional pressure against such investors to escape taxation altogether by converting their investments into tax-exempt securities.

Senator Barkley. Why do you specialize on this administration? All administrations have done that, haven't they? Why specialize on this one?

Mr. Seward. I do not think we have realized the seriousness of the tax-exempt security and the damage that it causes until very recently.

Senator Barkley. We cannot deal with that question now, because in all likelihood it would require constitutional amendment to tax all tax-exempt securities.

Mr. Seward. If it does, then the quicker we get it started the better.

Senator King. Mr. Witness, I doubt very much if you are including State tax-exempt securities and other political subdivisions. I doubt very much whether the people of the States would be willing to have the Federal Government tax their securities, but the Federal Government may tax its own.

Senator Barkley. It now taxes them on surtax, Senator. There is already a surtax on them.

Mr. Seward. On some of them; yes. I say a move of that kind would be more convincing than almost anything else that has been said or done to reform the tax system. I think that is one of the most serious evils in the tax systems.

Senator Barkley. I suppose it is not worth while spending time on it, but have you ever figured that if you tax all of these public securities, like the bonds of States, counties, and cities, and the
United States, which bears a low rate of interest because of their nontaxable character, that the interest rates would be raised and that the people would have to pay more interest on their public obligations. It would be the same as taking money out of one pocket and putting it into another.

Mr. Sennett. Gentlemen, there is no question but what that is absolutely correct, and yet I say a tax-exempt system of any kind has no place in a republic.

The Chairman. And we all very much agree with you.

Senator Longman. If it will give the witness any moral support, I will say that I am in hearty accord with his views.

Mr. Sennett. The maximum normal and surtax rates now total 76 percent. In addition, there is usually a substantial State income tax to be reckoned with. There is thus almost complete confiscation of income in the top brackets. The only haven for the taxpayer in that position is the tax-exempt security. It is useless to impose any such tax rates and expect to collect them to any substantial extent as long as that avenue of escape exists. The proposal to eliminate tax-exempt securities has been made to the Congress almost annually, but always it has been sidetracked. It would seem that the least that should be done in that regard is for this administration to stop pouring out additional billions of dollars in tax-exempt securities. That would be more convincing evidence of good statesmanship than almost anything else that has been said or done to reform our tax system.

For the year 1936 it is estimated that 247,000 corporations will report taxable income. Of these, some 214,000 will have net incomes of less than $10,000. The remaining 33,000 will have incomes in excess of $10,000. Thus, about 87 percent of our corporations are comparatively small enterprises. In the main, they have perhaps just about enough working capital with which to carry on, if such working capital is supplemented by the usual credit facilities of commercial banks. As to the larger businesses, their financial set-up ranges perhaps from bare insolvency to extreme liquidity.

Many of the largest and strongest of these companies have accumulated enormous liquid reserves. They are in the best possible position to avoid the payment of a penalty tax for failing to distribute all of their current income in dividends. It thus appears that under the proposed plan it is the largest and most successful companies that have the most positive assurance of going scot free of tax. At the other extreme are the corporations for whom the distribution of any part of their current income will be utterly impossible. Those are the companies whose reserves have been seriously depleted by 6 years of severe operating losses. It is they who are most entitled to avoid the payment of the penalty tax but are least likely to be able to do so.

Mr. Sennett. Yes, sir. I am referring to those companies at the other extreme who cannot distribute income. I have covered the companies who can distribute income.

In referring to depleted reserves, I do not necessarily mean that these companies have no surpluses. Their balance sheets might show substantial surpluses over and above paid-in capital. But businessmen understand that a corporation’s surplus, as shown by its balance sheet, is seldom represented by cash or its equivalent. Quite to the contrary, such surpluses are usually tied up in plant, equipment, and merchandise inventory.

It is a well-known fact that the only way in which some businesses can obtain additional funds is by reinvestment of their earnings. Even to the large, well-financed corporation which has managed to back its surplus by cash and liquid assets this plan will tend to discourage the draining of existing reserves. For they will know full well that such reserves cannot be rebuilt through the avenue of earnings. The freezing of such reserves is bound to have the exact opposite effect to what was intended. Instead of corporate reserves being spent, thereby creating employment for the unemployed, they will be frozen in the fear that they are not replaceable.

It is this very liquid capital that has been most severely depleted during the depression. That is the part of a company’s financial structure that must be rebuilt if ever we are to be on the road to full recovery. Yet here is the very point where the undistributed profits tax will make recoupment of accumulated losses impossible, or at least so costly as to appear undesirable.

Because of the penalty against the small and underfinanced corporation, there is bound to ensue a wholesale shifting in the method of doing business from the corporation to the partnership form. There will thus be lost to the small business the advantages accruing to its larger competitors who conduct their businesses in corporate form.

There would certainly seem to be something dead wrong with our process of reasoning when we profess to fear control by “big business” and yet legislate to keep big businesses big. That is exactly what this proposed plan will do. For even the corporation with a $10,000 income will have to pay a tax equal to 42 percent of the amount of income retained. In other words, if it has $100 of income, it will have to pay out $42 to the Government.

Senator King. You mean net income?

Mr. Sennett. Net income.

Senator George. That is where it keeps it all.

Mr. Sennett. No small business can survive any such cost for its working capital. We recommend therefore that the proposed rates in order to be workable and effective be substantially reduced. Also that they be simplified into a single schedule. This can be readily accomplished by allowing smaller corporations a tax exemption on the first $2,000 of income.

I think that would simplify the whole complicated schedule structure.

In the matter of taxing the stockholder, it is generally conceded that a tax on the corporation is in effect a tax on the stockholder. In that regard, Chairman Robert L. Doughton, of the House Ways and Means Committee, recently stated in part, as follows:

The earnings withheld by corporations add no less to the wealth of the shareholder than the earnings distributed in dividends: for the reinvestment of corporate earnings becomes reflected in the stockholder's share of the net worth of the corporation and in increased earning power.

Also—

To the extent that corporations do not disburse their current earnings, the additional revenues will be obtained from higher corporation income taxes corresponding as near as may be on the average to the rates that would have been by their shareholders if corporate earnings were fully distributed.
The point he is trying to make here is we ought to tax a corporation that does not distribute at about the same average tax rate as the normal and surtax rates, and that would be imposed against the individual stockholder if the distribution were in fact made.

With this as the background for the tax and the rate on undistributed profits, one would suppose that once the corporation has paid a tax equivalent in amount to both the normal and surtax rates on individuals, such tax-paid income, if thereafter distributed, would be tax free in the hands of the shareholder. How great is the shock, therefore, to find it proposed that such income be again taxed in the hands of the stockholders; and not alone for surtax purposes as heretofore, but for normal tax purposes as well.

Here is a rank inequality in taxing business profits. It certainly runs counter to one of the avowed purposes of the law which in the words of the President himself, seeks "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."

Why is not that a proper and fair thing to do if equity is what we seek in taxing businesses alike?

Senator Longman. I would like to ask a question at that point of one of the Treasury experts about the double taxation. Suppose a corporation invests part of its funds in the stock of another corporation that has already paid its tax on the earnings of the stock, the new ownership would have to pay a tax on that, would it not?

Mr. Turner. These dividends received went into their net income the same as any other net income and the tax depends on what the receiving corporation does in the way of dividend payment.

Senator Longman. I would like to ask the witness a question on that point. Do you regard that as double taxation? I very much regret that I did not follow you. Supposing corporation A owns stock in corporations B, C, D, E, F, and G, down the line, 25 of them, and all of those corporations have paid to the United States Government a tax, and corporation A has invested in those securities as a means of finding a safe place to invest for the building up of reserves, my question is: Is it fair for corporation A to pay a tax on the earnings of those investments? Is that double taxation?

Mr. Seidman. It certainly is if the corporations were taxed independently and then we just distributed to the upper holding company and it is taxed again.

Senator Longman. Yes.

Mr. Seidman. That is the worst possible double taxation.

Senator Black. Suppose a corporation makes $100,000 and it decided to keep $50,000 in reserve; it pays a tax on that $50,000, does it not?

Mr. Seidman. The corporation has earned $100,000 and has retained $50,000 in reserve!

Senator Black. Yes.

Mr. Seidman. Distributing the remaining $50,000?

Senator Black. I am talking about the first $50,000. Who pays the tax?

Mr. Seidman. Under the plan here?

Senator Black. Who pays the tax on that?
Such a broadening of the tax base should be designed deliberately to bring home to our people the cost of our enormous Government spending which they, the people, must ultimately pay for.

May I call your attention to section 102, subdivision (e), of the proposed law, which reads as follows:

(e) Payment of surtax on pro-rata share.—The tax imposed by this section shall not apply if all the shareholders of the corporation include (at the time of filing their returns) in their gross income their entire pro-rata share, whether distributed or not, of the retained net income of the corporation for each year. Any amount so included in the gross income of a shareholder shall be treated as a dividend received. Any subsequent distribution made by the corporation out of earnings or profits for such taxable year shall, if distributed to any shareholder who has so included in his gross income his pro-rata share, be exempt from tax in the amount of the share so included.

Here is an excellent provision in connection with surtax evasion and an excellent example of how cash distributions can be made unnecessary and how tax duplication can be avoided. Why can't a similar provision be made to extend to the treatment of the undistributed profits tax! This would give to the stockholders of the corporation a simple means of being taxed individually on their pro-rata share of corporate income, without making it necessary for the corporation to actually distribute the income in cash or its equivalent. Such a provision would simplify the entire problem of distribution and would enable the vast majority of corporations to be treated as partnerships for tax purposes, and thus would more nearly accomplish equality in the taxation of business profits. Perhaps, as many as 9 out of every 10 corporations could take advantage of such a provision.

The Chairman. Have you estimated the loss to the Government by extending that as you have suggested in revenue?

Mr. Sedman. I haven't estimated the loss, but I say you haven't done it; and what's more, you have aggravated the situation, you have, to some extent, a duplication of taxation in the present law. The tax distribution is for normal purposes.

The Chairman. That would come back to the same proposition. If the reserve held by the corporation must be tax exempt. Do you figure that whatever reserve is retained by a corporation should be tax exempt until it is distributed?

Mr. Sedman. No. I say let the corporation pay the tax on that. If the label that income tax free whenever it is distributed, it is tax free to the stockholder. That is exactly what you have done in section 102.

If all the stockholders of a corporation, in order to ease the tax burden of the company and in order to conserve its working capital, are willing to pick up every dollar of the company's income in their own tax returns and pay a tax on it at normal surtax rates, the Government should have no complaint. That is all the Government can hope to collect from the more prosperous companies, who are in a position to distribute all their current income and hence escape paying an undistributed-profit tax.

Several other serious defects in the bill should receive consideration. The present revenue act does not permit corporations to file returns. If more corporations it is the consolidated net income that is the true net income for that business. The loss of one corporation in the group must necessarily be offset against the profit of another before true income is arrived at. For many years our income-tax laws did in fact recognize this truth and permitted the filing of consolidated returns by affiliated companies. But, when our Government's fiscal needs began to overshadow the element of equity and fairness in our tax laws, the consolidated return was thrown overboard. Such an inequity may be bearable under an arrangement where a corporation is subjected to an income tax of from 12 1/2 percent to 15 percent as is now the case, but it will certainly be intolerable under any such plan as would tax retained corporate income at rates running up as high as 75 percent.

The same comments could well apply to the treatment of capital losses. At present capital gains are taxable, but capital losses in excess of such gains are limited in deductibility to a $2,000 maximum. When a business is to be taxed at anything like the proposed rates on its entire net income, including capital gains, the very least to be expected is that the tax be imposed on true net income after all legitimate business losses are deducted.

For the same reasons, losses of one year should be permitted as a carry-over deduction against the profits of at least the two succeeding years. We have learned by sad experience that profits and losses have their peaks and valleys. If an extremely high rate of tax is to be imposed against profits of 1 year, it is only fair and just that the losses of the immediately preceding years be given some consideration in determining the tax liability.

Permit me also to direct your attention to section 27, subdivision (j) of the proposed law on the subject of intercorporate dividends. This provides that corporations, 80 percent or more of whose gross income is derived from dividends, shall, in figuring their undistributed-profits tax, be deprived of so much of the dividend credit as is equal to the amount of income accruing to a corporate shareholder owning 50 percent or more of the taxpayer's stock. In effect, what this means is that even if such a company distributes every dollar of its income, it may nevertheless have to pay 42 1/2 percent of its income in undistributed-profits tax.

Imposing such a tax on the earnings of a subsidiary company within a corporate structure means certain death to the subsidiary. Last year this Congress was engaged in a desperately fought controversy over a so-called death sentence proposed against certain public-utility holding companies. Following many months of consideration and discussion of the subject, the proposal was defeated. Yet here, in this law is proposed a virtual death sentence not alone against public-utility holding companies but against all holding companies of the nature here described. The proposal comes out of a clear sky, without any notice whatsoever to these companies. It was not even mentioned when the Ways and Means Committee held its public hearings on this bill.

Presumably there are many instances in which the corporate structure can and should be simplified. Our laws in the past encouraged such complicated structures. On the other hand, there must be numerous instances in which corporate structures of this nature are necessary and invaluable in the conduct of large businesses. This is certainly true where business operations extend into many States and are thus subject to many State laws.
Senator Kino. And where it extends into other countries, such as Chile and Mexico, where you cannot conduct business there as an American corporation, you have to organize a Chilean corporation and place all of your stock with the Government before you can get a charter, and you must organize a corporation in Mexico and place your stock there; so that if you and I should organize a company here, such as a mining company, and decide to branch out into Mexico and Chile, we would have to organize a company in Chile and another in Mexico; we would be the holding company, and Mexico and Chile would tax very heavily, and any dividends that would come back to the holding company, I was wondering whether there would be anything left.

Mr. Seidman. There may be thousands of instances which require these subsidiary companies to be formed in which they have been formed; yet we are about to put them to death.

Senator Kino. They have to organize these companies in order to do business.

Mr. Seidman. Of course.

Assuming, however, that the elimination of all such corporations is desirable, and that it is the Government’s business to so legislate, there is surely no occasion for any such strong-arm methods as are proposed in this law. I submit that if such holding companies are to be penalized for living, they ought to at least be given a fair trial and an opportunity to justify their existence before they are summarily condemned. If they cannot do so, then and only then should they be forced to go into liquidation by a certain, reasonably far-removed date in the future.

The law is chock full of nonconstrued provisions, which are sure to come litigation for many years to come. It has been dubbed the “most complicated piece of legislation in 50 years.” Its intricacies and its controversial provisions are bound to have serious effect upon the productivity of the tax and the temper of the business community.

Simplification is possible only by further detailed study, discussion, and consideration. To enact such revolutionary changes in our tax system without ample and mature consideration is unthinkable.

Business is worried over the uncertainty produced by the constant changing of our tax laws. Changes of tremendous importance are made after much bickering and controversy, only to be again changed 6 months or a year later, often before the earlier enactments have been given a chance to prove their own worthiness. Last summer Congress and business sweated for many weeks on a tax bill. The most bitterly fought provision of that bill involved the principle of taxing corporate “bigness” as such. That provision now goes out the window for something which may suffer the same fate 6 months or a year hence.

It is the uncertainty and unreliability of our constantly changing tax laws that makes for a lag in confidence and for delay in return to business normalcy. This proposed bill embodies some of the most revolutionary changes since the enactment of the sixteenth amendment. We must be sure we are right before we make any more radical changes in our tax laws.

Thank you, gentlemen.
Senator BLACK. In 1934 and 1935, when the committee had its hearings, do you recall testifying against that bill?

Mr. SEIDMAN. I know I testified in favor of closing up loopholes.

Senator BLACK. You appeared this morning favoring the idea of taxation of undistributed profits. I understood in one statement—

The CHAIRMAN. He only approved in a general way the principle and facility of the thing.

Senator BING. He approved the theory but is against the practice.

Mr. SEIDMAN. Yes.

Senator BLACK. In other words, you think you have not had time in which to work all of that out?

Mr. SEIDMAN. Yes, sir.

Senator BLACK. You think it takes more time?

Mr. SEIDMAN. Yes, sir.

Senator BLACK. Have you ever read Mr. Jeremy Bentham's Current Fallacies of Anti-Reformers?

Mr. SEIDMAN. No, sir.

Senator BLACK. I would appreciate it if you would read the speech of Mr. Neddles that appears in that discourse in an interpretation of Mr. Sydney Smith of Bentham's Fallacies. I think if you will read that you will recall of the arguments that you have made here this morning—

I favor the philosophy and theory, but this is not the proper time.

Mr. SEIDMAN. I would appreciate reading it.

Senator BLACK. I am sure you will enjoy it.

Mr. SEIDMAN. The point, gentlemen, is not so much the time, but it will not work with tax-exempt securities and 75-percent surplus.

Senator BLACK. You favor it, but this is not the proper time; you think we have not studied it long enough, and there are certain things that make it impossible to put it into effect?

Mr. SEIDMAN. It would be a good thing to make sure the rates are reasonable the thing can work, but it is handicapped—

Senator BLACK. I understood you also were very fearful it would hinder the small corporations.

Mr. SEIDMAN. Yes, sir.

Senator BLACK. Do you have a list of the contributors to the association you represent and the names of the companies that your organization works for as public accountants?

Mr. SEIDMAN. Contributors to what?

Senator BLACK. To the New York Board of Trade.

Mr. SEIDMAN. You mean the membership of the association?

Senator BLACK. Are there any large companies that belong to that organization?

Mr. SEIDMAN. May I say, Mr. Senator, that the New York Board of Trade is made up of large companies and small companies.

Senator BLACK. What large companies?

Mr. SEIDMAN. The small companies predominate.

Senator BLACK. What large companies have you discussed the tax measure with which belong to it?

Mr. SEIDMAN. In the first place, I cannot—

Senator BLACK. Does the Guaranty Trust Co. belong to it?

Mr. SEIDMAN. Yes, sir.

Senator BLACK. Does the City National Bank belong to it?

Mr. SEIDMAN. Yes, sir.

Senator BLACK. The Chase National Bank?

Mr. SEIDMAN. I believe it does.

Senator BLACK. Do you know whether or not the Electric Bond & Share belongs to it?

Mr. SEIDMAN. I do not think so.

Senator BLACK. You do not think so?

Mr. SEIDMAN. No, sir.

Senator BLACK. Do you know whether or not any of its associates belong to it?

Mr. SEIDMAN. Quite likely.

Senator BLACK. Do you do work for any of the companies I have mentioned?

Mr. SEIDMAN. I do not.

Senator BLACK. Does your firm do work for them?

Mr. SEIDMAN. My firm does not.

Senator BLACK. Is it engaged in independent accounting?

Mr. SEIDMAN. Yes, sir.

Senator BLACK. And you have appeared here each time for the New York Board of Trade, and still nobody has paid you for your appearance at all?

Mr. SEIDMAN. That is correct.

Senator BLACK. In each instance?

Mr. SEIDMAN. Yes.

Senator BLACK. And you appear voluntarily as a citizen?

Mr. SEIDMAN. That is right.

Senator BLACK. What is the name of your company?

Mr. SEIDMAN. Seidman & Seidman, certified accountants.

Senator BLACK. Where is its office?

Mr. SEIDMAN. New York City, head office.

Senator BLACK. At what place?

Mr. SEIDMAN. New York City.

Senator BLACK. What place in New York City?

Mr. SEIDMAN. The street number?

Senator BLACK. Yes.

Mr. SEIDMAN. 80 Broad Street.

Senator BLACK. Is that an office building?

Mr. SEIDMAN. Yes.

Senator BLACK. What?

Mr. SEIDMAN. Two thousand six hundred.

Senator BLACK. And who else is in your firm?

Mr. SEIDMAN. Just three brothers.

Senator BLACK. Three brothers?

Mr. SEIDMAN. Yes.

Senator BLACK. Have they appeared, also? Did you appear in connection with the holding company bill?

Mr. SEIDMAN. No, sir.

Senator BLACK. You took no part in it?

Mr. SEIDMAN. No, sir.
Mr. SPRINGER. Mr. Chairman, for the purpose of the record, my name is Durand W. Springer, secretary of the American Society of Certified Public Accountants, and in presenting Dr. Klein as our representative I want to say for the benefit of you who may not know it that at one time he was the tax editor of the New York Globe and professor of taxation in the City College of New York, an author of a very much read book on income taxation.

He has been president of the New York State Society of Certified Public Accountants, and is now acting in the capacity of chairman of our committee on Federal legislation. The report which you have before you gives the names of the committee on this committee and their residences.

We had a meeting of our board of directors here on Monday and Tuesday of this week, at which the points he will present were discussed and approved, so that what he will say to you will come as the result of conferences in which 22 States have been represented by the two.

I might merely add one other statement, that if we were to come to you with any desire to take advantage of a possible opportunity for profitable gain, there would be nothing better that we could do than to urge that you pass the bill as it is, because certainly it would increase the volume of practice which the independent accountants would have during the succeeding year.

Dr. Klein will now make his statement to you.

STATEMENT OF JOSEPH J. KLEIN, NEW YORK CITY, CHAIRMAN OF THE COMMITTEE ON FEDERAL LEGISLATION OF THE AMERICAN SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS

The Chairman. Doctor, you have a memorandum here, and suppose we put that in the record, and that within 20 minutes you pick out the salient things you want to tell the committee, because we have a great number of witnesses here.

Dr. KLEIN. I sympathize with you, Mr. Chairman, and after the first 3 minutes whenever you feel I am not constructively useful, sound your gavel and I will quit.

The Chairman. That is all right; you just get through as quickly as you can and we will put this brief in the record.

Dr. KLEIN. First of all, I shall not say anything more about the simplicity or the complexity of this bill. You indicated, I think, Mr. Chairman, during the course of this morning’s discussion, that the bill when it finally emerges may be decidedly and fundamentally different from what it now appears to be.

The Chairman. I do not know whether I said that.

Dr. KLEIN. If not, sir, then the cruel punishment that might be meted out to the members of this committee, and I here recall the procedure of the college of cardinals, no crueler punishment should be meted out in behalf of those who vote for the bill in its present form than placing themselves without food until they solved a simple problem which I have prepared to submit for such purposes.

One other matter regarding the simplicity I think I ought to touch upon. I thing the bill has been unfairly criticized after a superficial reading of it, because of the presence of four tables, and refer-
change Commission can give you those figures if you are interested in them.

I know how difficult it is in practice to ascertain the profits resulting from such sales, but it is not an insurmountable difficult task, because by imposing a flat tax the same as on other income applying to foreigners, predicated on the arbitrary assumption of saying that 25 percent of the selling price represents profit, with full opportunity to the person involved to prove what the true profit was, I think some unnecessary losses will be avoided.

I am not prepared to say exactly how much additional revenue must be raised, but I read this morning the statement of the Secretary before this honorable body of yesterday, and I read his comment that in assuming revenue he is pessimistic and in assuming disbursement he is optimistic, which I think is wise budgetary procedure.

Nevertheless, I think it is illuminable that there is no evidence in person or otherwise, so far as the deliberations of the Ways and Means Committee are concerned, that any attempt was made to ascertain whether or not such disbursements may not be diminished.

I do not doubt at all that such investigation may have been conducted and was considered, but I say it is illuminable there is no evidence of the fact that such consideration actually occurred.

May I speak for a moment on the constitutionality of the bill before you, and I am not for a moment claiming this bill is unconstitutional in any of its major parts.

The CHAIRMAN. Doctor, are you a lawyer?

Dr. KLEIN. Yes, sir; but, despite that fact, I make an honest living.

The CHAIRMAN. Some people who are not lawyers like to speak on constitutional questions, is the reason I ask.

Dr. KLEIN. I will not argue with anyone who claims it is constitutional. I do not know, and no modest man knows, since the surprises that have come to you from a place not far from this room. Even Mr. Kent will not be sure.

But, I say to you, just suppose by the barest, the wildest possibility that this bill turns out in its major part to be unconstitutional; what is the result? You have given up $229,000,000,000 on computed income under existing levies, subject to the wildest sort of adjustment by the statisticians I suppose, when they get down with their pencils to figure it, for something supposed to result in $620,000,000,000 additional revenue.

I have had nothing to do with provisions of this sort, optimistic and pessimistic, but I realize that history has a way of dealing with them, but those who are charged with enacting this legislation must know they are foregoing a tremendously positive assured income for an income which it is barely possible may turn out to be elusive.

Fortunately the alternative is not as hard at this moment as it may appear to be in either the present law or the present bill.

If the Congress has the intent of levying a tax on undistributed corporation earnings, I imagine there is much to be said in favor of that principle, but like so many other things, the gap between practice and principle is so wide.

As the President first announced the theory, I think it sounded a responsive chord in the minds of many who publicly claim to be
opposed to anything that emanates from the White House today, but the Ways and Means Committee found, as you will note, that you cannot apply that principle as is without modification, without adjustment, without special consideration, which accounts for the turn to the actual complexity of the bill.

If you were merely intent upon producing a bill of a few lines it could be very simple, but it would have to be unfair, and one must concede in the endeavor to modify the harshness of the enforcement provisions as introduced, which added to the complexity of the measure, I think we may overemphasize what has been referred to as the short-sighted policy, I think it was by Mr. Edmonds in this morning's session when he referred to the peaks and hollows in our income taxes. It is simply a human break that cannot be all good and all bad.

It cannot be negativized that this tax will put in a preferred position the corporate corporations, the corporations well-heeled with surpluses from past years.

Perhaps it is unavoidable, but on the other hand it is not perhaps to the extent that has already been pointed out, and perhaps not to the extent that some others, who are less restrained than I am, will insist, but there it is.

The CHAIRMAN. Have you any constructive suggestion as to how we can regulate this so that we can get some fair amount of revenue from them?

Dr. KLEIN. I would not have the heart to come before this body merely to criticize a measure that deserved the criticism without attempting to offer constructive suggestions.

Perhaps those suggestions so regarded by me as constructive suggestions may be worse than those before you, but at least they are sincerely expected to be helpful.

Here is a constructive suggestion, to extend the provisions in the existing law, sections 102 and 351, retaining the existing taxes, supplemented, changed, and modified, as I shall later indicate, supplemented by an experimental tax on undistributed earnings.

Let us try it out, and if it works, if it is constitutional, go the whole length if you are thus disposed.

Under existing section 351, as you know, corporations, personal holding companies, and others which fail to distribute at least 90 percent of their net income, slightly adjusted, are subject to the tax that runs from 20 to 60 percent. Extend that, if you will, to corporations that seem to you to be in mind, when you refer to a handful of individuals that control the destinies of the corporations to their own tax enrichment.

I suppose the Mellon companies would be a splendid example of that type that ought to be brought under section 351, and I would shed no tears, if that is what you decided to do.

I should think Mr. Ford's corporation might well be brought within the purview of section 351.

Section 102 of the present law deals, as you know, with so-called personal holding companies and so-called investment companies, and with a great many unreasonable in size. I doubt very much whether the ingenuity of the present administration officials, and that splendid body of public service technicians who carry on the Treasury Department, when the officials come and go, cannot put teeth into sections 351 and 102. I would hate to admit their inability in that direction.

As to the experimental levy along the lines of the bill, after your net income, and after you tax the net income, I will suggest that after certain adjustments the undistributed surplus, experimentally it seems to me, might be subject to a very simple schedule of rates, say, 1 percent on the first 10 percent not distributed, 2 percent on the next 10 percent, and so on until 10 percent on all of that net income is reached. I submit it would work; it may not yield your revenue, but it is very much similar to the rates you have been asked to consider.

The CHAIRMAN. That proposition was presented to us some years ago, but the Senate would not accept it.

Dr. KLEIN. I did not get that, Mr. Chairman.

The CHAIRMAN. I say that principle was presented in a minority report when we happened to be in the minority, but our Republican brothers would not accept it.

Dr. KLEIN. You will not resent my saying that perhaps Congress, as well as the rest of us, develop.

The CHAIRMAN. I am glad to know you think we were right, then, as we are right now.

Dr. KLEIN. You may have been wrong both times, and right both times, because times change.

I imagine that large businessmen, and you know someone referred to the fact that businessmen might be put in quotation marks, that big businessmen might be happy to accept today what they rejected 3 or 4 years ago.

If you wish to retain this category of classification of corporations, I suggest the following for the normal ordinary corporation without special profits, a tax of 20 percent on ordinary income, and I suppose my clients will lynch me when they read of this.

Senator KING. Net income, you mean?

Dr. KLEIN. Ordinary income as defined in the existing law, deduction to be allowed for capital losses, both securities and capital assets, but in no event to increase the taxable income by more than 25 percent. That would mean that the 20 percent might drop to 17 percent, but not beyond that.

That distribution also be allowed of income in the hands of individuals, and I wish you would follow me closely in this, limited, however, to one-third of the amount of such distribution, and in no event reduce the tax by more than 25 percent of the amount of the tax.

In other words, this would encourage, not what was determined by some speaker this morning, as most of what he said I disagree with, the sledge-hammer methods but by that persuasive worth while economic advantageous method. This would permit payment of three-quarters of the amount of current earnings at a tax-benefit to the distributing corporation.

Now, as to personal holding companies and investment holding companies, practically what I said a moment ago applies, and I shall not repeat it.

The companies in bankruptcy, and those in other forms of court reorganization proceedings, I should think that a 10-percent tax, although I do not think it makes much difference in the long run
whether you say 10 or 30, you will not collect much there, but it looks well, I think, to limit to about 10 percent.

The Chairman. Mr. Klein, in making these suggestions, of course, you have figured out what the estimate would be in the matter of increased revenue.

Dr. Klein. No, sir. I know, is intended in your question, but it should have been, sir. Of course, I made no attempt to do so, but I have worked with the committee long enough to know you have at your beck and call statisticians much able than I to handle this problem, and who have figures and basic facts which are not available to me.

The Chairman. Of course, we have to look at the amount of revenue to be derived, as you know.

Dr. Klein. I understand. In the days of McCoy he could answer in 5 minutes, but it takes longer now.

It ought to be some special provision for distribution by corporations that because of either binding contract arrangements or because of statutory prohibitions they cannot make distribution, one again 20 percent on their net income; once again a limited allowance for capital issues; and once again a similarly limited allowance for the distribution which would not be made under statutes; (b) if you wish, for some limited amount of voluntary amortization of debt or under the present bill, but all such limited altogether at not more than one-fourth of the tax rate, which is another way of expressing it.

Something was said this morning by an eloquent witness about the need of encouraging business to establish uniformity. I have a definite, and I hope a constructive suggestion to make along those lines.

Billions have been spent by the Government in connection with direct and indirect relief; many millions have been spent in the endeavor to decrease unemployment.

In the heavy-goods industry, while I have no figures to submit, I am quite positive that local, State, and National expenditures in this direction have not attained results which are pleasing to anybody.

My constructive suggestion, therefore, while, of course, I may be wrong, at least deals with an attempt to do something about unemployment where it is the worst today—in the heavy-goods industry.

Suppose you were to permit as a deduction from that same net-income figure to a very limited extent, and at the present time I suggest not more than 2 percent, of 50 percent of the amount of income to the 20 percent, and at the present time I distributed in the first year, and limited so far as reduction of taxes percent, would be 4 with respect to 30 percent, but this time only for, but actually spent—not contracted plant and equipment.

I hope that no similar suggestion will have to be made for the next following year.

Where are you going to get all of this money from if some of it is not sloughed off? I do not know that any of it will be sloughed off.

I make the suggestion now in the belief that the bonus legislation, which was referred to at least twice this morning, was enacted because Congress believed there was an overwhelming demand for it.

Why should not the great public be permitted to share in the financing of the precipitated Budget? I shall not go into the philosophy of direct and indirect taxation, but I do submit that if a direct tax was ever justified it is for the support and financing of a measure that seemed to be overwhelmingly popular, and I submit that recommendation; and here I have some figures, Mr. Chairman, which I will submit.

The possibility of a tax on salt, which at 1 cent per pound would yield—

Senator King. What did that do toward precipitating the French Revolution?

Dr. Klein. It brought it about, I believe, as we are told.

Senator Black. That kind of a tax was not popular in England.

Dr. Klein. I am not sure, but I think Senator King's reference to the French Revolution is correct. Let me give you the figure. A tax on salt at 1 cent per pound would be $122,421,000, on the basis of the consumption of 1934. I am not surprised that you are surprised at such a figure.

The Chairman. Have you figured what part of that tax Utah would bear to the whole amount?

Dr. Klein. What is that, Mr. Chairman?

The Chairman. Have you figured what amount of that tax Utah would bear, as compared to the whole amount, in that salt tax?

Dr. Klein. I think Utah would be more interested in the sugar tax, which I will come to next.

Senator Barkley. If you tax salt, you will tax salt used for human consumption only.

Dr. Klein. I figure there will be something less than the figure I gave, on refinement. I am not much of a politician, but I think the salt tax is an ideal tax, although it may be said that it was the primary cause of the French Revolution, to which reference has been made.

Senator King. Why don't you put it on tea?

Dr. Klein. We will come to that later. I do not drink tea. Because of the abstract fact that in 1935 there were less than 100 corporate producers of salt, the tax could be very easily levied at the source.

To come to the next point, sugar, both which is produced domestically, as well as that which is imported, at 1 cent per pound would yield $130,000,000, and the tax could be easily collected either at the point of import, with respect to foreign sugar, and at the domestic refineries on the domestic sugar.

A tax on coffee at 5 cents per pound, according to the 1935 figures of consumption, would yield $75,000,000.

Now coming to tea, no matter how much you raise the ante on it you cannot get much from it. At 10 cents a pound, it would be only $19,000,000, based on the 1934 consumption.

Now, I come to a subject that Senator Hastings, I think, would be interested in, as it does not affect his State. This is the question of intercorporate dividends.

The Chairman. Why wouldn't Senator Hastings be interested in it?
Dr. Klein. I will make that clear, in the hearings on the 1933 act, and I go by the record now. Senator Hastings refreshed the recollections of his colleagues by referring to the fact that when the so-called utility death bill was under consideration he or somebody else had stated that if you are going to compel the break up of these pyramidal structures—and I hold no brief for them; they are abnormalities in many respects—that there ought to be some tax easing out of the situation, and, as I recall, it was in the Senate, and not on the other side of the Capitol, that section 110 (h) was introduced, amending section 112 of the 1934 act, which permitted, as I recall it, a tax-free break-up for the liquidation if consummated within a 5-year period.

In the new bill reference was made to it, and at this point I think the record ought to be corrected, because without intention misstatement was given to the committee.

Under the provisions of the bill before you, if a corporation distributes its income to the controlling corporation—that is, from corporation B to corporation A—and if A owns more than 50 percent of B, the distributing corporation may not reduce its tax because of that dividend distribution, and if you have a chain of corporations, there is a carve-out as it goes on each step in the process, at a diminishing percent, but eventually you do approach a figure which approaches, although you cannot reach entirely a zero balance.

I submit, and this is what I thought Senator Hastings might be particularly interested in, that of these corporations that have availed themselves of your invitation of last year to disappear from the scene as pyramids and were started on that process, which must take some time, of course, they ought not to be subjected to this penalty.

Certainly a corporation series or group of corporations integrated in this fashion, which takes all of its earnings and passes them rapidly through the group to the top company, which makes a distribution, all within the tax year in which it was earned, ought not to be subject to this penalty, because, after all, even under the bill all you intend to do is to tax the earnings once, if not distributed, and I submit that is an unfounded invention of those who drafted this provision, unless they worked under such pressure they really didn't see all of the consequences, which, of course, is a human possibility.

Senator King. Have you prepared an amendment which will obviate the evils of which you complain?

Dr. Klein. I am a very poor draftsman, but I would be glad to submit what I think will do it.

The Chairman. All of our draftsman, and they are taking down notes.

Dr. Klein. I am sure of that. Here is something for which my society is not responsible, but you may welcome it, and on this I think the Treasury as well as you will admit that as your tax burden becomes more onerous there is a great conflict between the taxgatherer and the potential taxpayer, and that accounts in some manner, if not entirely, for the large number of American-owned foreign corporations they do business without paying any tax on their profits except to the extent it is American business and it is discovered, and, strange as it may seem, upon the death of the stockholders in such corporations, you wipe the slate clean, and all of that increment of income escapes taxation.

I submit that someone along the line of section 112 (h) I believe it is, you might well enough provide for the return of such American owners of foreign corporations under terms which would not make the return too onerous, and thus bring them within the purview of the taxing authorities, and I make two constructive suggestions:

(1) If the corporation is broken up and the assets taken down, to subject the profit that is there to a flat tax, and I submit 12.5 percent merely for the sake of discussion; and

(2) That where an American company is established, or is already in existence, which takes down such assets, they should be permitted to do so under the terms and conditions similar to those which you introduced in the 1935 act with respect to the liquidation of pyramided corporations.

I now come to the very last suggestion, and it is this: You will not get a perfect tax bill whether you try to do the job in a week or in a year. The measure before you now requires tremendous reworking both for administrative and for fiscal reasons, in my opinion.

I suggest that instead of trying to tinker with this law at this time, and that is all you are doing, you are not making an effort at revision, that some joint committee be appointed to study the entire subject of tax legislation, with a purpose which is more necessary today than it was 3 or 4 years ago, for more effective cooperation between the State taxing bodies and the national tax-legislation administration, and meanwhile, because whether we like it or not, revenue must be raised. That cannot be left open, and it is nobody's fault that you are confronted with this situation.

Senator King. Would you support the resolution I offered in the Senate some time ago to have the President of the United States confer with all of the States and have the State and Federal Government appoint a body—delegate ambassadors, or whatever you may call them—for the purpose of working out a plan as far as possible for the coordination of the State and Federal Government so that there would not be duplication in taxation as it now exists; but nothing has been done about it.

Dr. Klein. I am in entire accord with you on that, Senator, and I venture to say that sooner or later they will come to you.

Senator King. Mr. Graves, a very able tax man of New York, and others, met here about a year ago and examined the proposition.

Dr. Klein. Yes; I know him very well.

Senator King. And I thought they were going forward with the plan to bring about such a conference.

Dr. Klein. I cannot say off the record, so therefore it will have to be on the record, that New York is a little timid about that, because I am sure that while it is accidental—but whenever we pool our revenue from the States the State of Texas seems to get a larger share than New York does proportionately.

Senator Black. May I ask whether New York sells anything to Texas on which they make a profit?

Dr. Klein. Yes; but they would like to sell more. You cannot get me to argue about Texas, because I have a soft spot for that State.
Senator Black. I understood you to say that Texas got more than
New York and I wanted to know whether New York got anything
in the way of profit on the things produced and sold in Texas.
Dr. Klein, yes; but I think it is more or less a geographical
question.
Senator Black. You think it is geographical?
Dr. Klein. Sir, you have got me all wrong; I am really praising
New York. In New York you regard Texas as one of the
richest suburbs of New York City.
Dr. Klein. Not for plucking; if that is what you mean.
Senator Connally. You have plucked them so bad that there is
not much left now.
Dr. Klein. You cannot get me to argue about Texas because as I
said I have a soft spot for that State. I am through now in a few
seconds except for your questions, if you have any to ask.

The situation is that as to temporary emergency revenue we are
restricted to an essential minimum to provide for current expenses
and for the fiscal year while this entire problem shall be investi-
gated from one or more of the following sources: Increased rates
on corporate incomes and you have indicated what I think might be
a fair figure; increased normal rates on individual incomes, 1 per-
cent and surely not more than 2 percent; reduced personal exemp-
tions somewhat above the British level, subjecting dividends received
by individuals and to some extent by corporations, to the normal
tax; the share tax on nonresident aliens and nonresident corpora-
tions; a small unit tax on one or more of the commodities I have
referred to, and the chances are you will be able to select the com-
modities which will lend themselves to this sort of taxation much
better than I am able to do so.

The Chairman. Thank you very much, Mr. Klein. Your discus-
sion has been very instructive, and we will have included in the rec-
ord at this point the brief submitted by you.

(The brief referred to is as follows:)

THE AMERICAN SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS,
Washington, D. C.

MEMORANDUM PREPARED FOR SUBMISSION TO THE FINANCE COMMITTEE OF THE
SENATE REVENUE BILL OF 1936

The revenue bill under discussion deals with a number of matters, but I do
submit represents my views as chairman of the committee on Federal legisla-
tion, except where otherwise indicated or implied, are shared by the board
of directors and by my fellow committee.

Besides criticism of selected provisions of the bill, specific and detailed con-
structive suggestions are offered and, in addition, there are presented for con-
Sideration specific as well as general changes and modifications and a funda-
mental revision. All of this is arranged in 15 sections.

Respectfully submitted.

JOSEPH J. KLEIN,
Chairman, Committee on Federal Legislation, the
American Society of Certified Public Accountants.
II. A GENERAL SURVEY, WITH SPECIAL REFERENCE TO COMMENDABLE FEATURES OF THE BILL.

Aside from the complexity of the bill which, if its philosophy is to be adopted, is inevitable in the attempt to avoid undue harshness, the proposed bills contain some commendable features which deserve praise. On the other hand, there are grave reasons why the bill should not be approved, and these I intend to present as courteously as possible in fulfillment of the desire of the American Society of Certified Public Accountants to continue its constructive aid to the legislative and administrative branches of the Government.

Among the commendable features of the bills, for procedural or substantive reasons, or for both, are:

1. A flat 15 percent tax (in lieu of the complicated levies under Sec. 18) on selected corporations such as banks, insurance companies, foreign corporations doing business in the United States, and, most especially, companies in receivership and "delict" corporations.

2. In principle, the provisions (possibly unnecessarily complicated) which are intended to lighten the tax burden on corporations with prior deficits, those prohibited by binding agreements with creditors from disbursing earnings, and debt-ridden corporations which wish voluntarily to amortize their debts.

3. Early elimination of the capital stock and excess-profit taxes.

4. Subjecting dividends to the normal tax, despite the theoretical equity of offsetting the exact amount of corporate taxes paid prior to distribution (as was the case under the 1913 and 1916 acts) by an equivalent exemption to the recipient stockholder.

5. The dividend "carry-over" provision. (It is unfortunate, in view of the heavy taxes proposed, that a similar carry-over of net losses was not incorporated through a simplified version of Sec. 204 of the 1921 act and in the spirit of the corresponding British tax procedure.)

6. Liberalization of provision dealing with the tax incident to complete liquidation; the provision should be extended to the two types of partial liquidation, myself, I suggest a flat rate of 15 percent (instead of 10 percent proposed for individual film income of nonresident alien individuals, partnerships, and other entities, without business activity in the United States.)

7. Recognition of the bill, together with constructive recommendations, will now be stated very briefly.

III. SOUND LIMITATION ON REVENUE INCREASE

While it is realized that current expenditures of the Government should be met currently, and while no competent person would advocate the meeting of present expenses by increased deficits, at the very threshold of our inquiry as to the amount of additional revenue required, we are struck by the absence of a suitable budgetary experience. In this field they have assisted governments in their own recent domestic economic activity, they have also been confronted with the problem of budget balancing. Professional accountants, among the problems they did not study and examine the disbursement phase of the latter. With the full text of the Senate Committee on Finance, the report, it is in accord with reasonable belief that the present budget is sound in its fiscal phase, and that the revenue raised will suffice to meet the expenses of the Government.

Although it is the burden of the Committee to provide the necessary tax and the acceleration of the budgetary process and the acceleration of the budgetary process by reducing current revenue needs, as far as is possible, portion of the deficit, the deflation of the deficit which cannot be met by elimination and reduction of expenditures. Such additional taxes should be temporary, levies necessary for doing business, and should not be made a part of our permanent tax system.

6. ALIEN JUSTIFICATION FOR INCREASING CORPORATE TAXES

Among the reasons which I have heard advanced in justification of the proposal for an undistributed corporate net income tax, one which has a popular appeal. It is that, aside from the question of additional revenue needs, the advantages and privileges of corporations, as compared with partnerships and sole proprietorships, are readily subject to a heavier tax; also, that, in the past, corporations have enjoyed tax benefits denied to partnerships and sole proprietorships. Let us look at the record.

From 1900 to 1915, corporations were subject to a Federal income tax, although it was not until 1913 that individuals became subject to income tax. During 1913, corporations were subject to a combined income tax and excess-profits tax which attained a maximum of 82.4 percent; the corresponding maximum tax applicable to individuals was 77.4 percent. However, dividends distributed by corporations (which, as stated, might have paid a maximum of 82.4 percent) became subject to a surtax in the hands of recipient stockholders up to a maximum of 65 percent (and, or in a combined tax of 93.84 percent. Corporations were also, of course, subject to Federal and State taxes on capital. During later years, the tax on individuals, relative to that on corporations, became higher, so that it is true that in many instances there was, and still is, tax economy in conducting business as a corporation. There is economic justification for some differentiation, because a stockholder of a corporation does not actually enjoy corporate profits until they are made available in his, as was recognized by the Supreme Court inrender v. Yost (252 U.S. 519). However, from the viewpoint of Federal, State, and local taxation, the advantage no longer exist in favor of conducting small enterprises in corporate form.

V. CONSTITUTIONALITY OF THE REVENUE BILL

Speaking for myself, may I venture to assert that it takes considerable ingenuity to formulate an unconstitutional law taxing corporations? While the unreasonableness of revenue acts has never been attacked because of the presence of two redundant and almost unanswerable of rates, challenge has been based on alleged lack of required uniformity of burden, on the creation of irrebuttable presumptions, and on other grounds; other Federal legislation has also been attacked on the ground of improper delegation of authority because of conflict with the due-process clause, and because of arbitrariness and discrimination.

The members of the accounting profession do not pose as experts on constitutional construction. There are elements in the constitutional conflict about constitutionality. It is somewhat questionable whether a tax which requires the mathematical calculation which this bill imposes on the taxpayer would find support in the courts, especially if the rate of the issue is attempted to calculate the tax. More important, however, I might direct my attention to that provision of the Act, in section 16, which makes the Commissioner's decision final, that is, irrebuttable. I am in some doubt as to whether the courts would sustain a palpably arbitrary decision by the Commissioner when the available facts clearly negatived the correctness of his conclusion. Quite evidently, too, the tax is not measured by either gross or net income, but on a radically different basis. Also, there is manifest discrimination, possible on arbitrary, among classes of corporations. What the attitude of the courts will be with respect to such a heavy assessment is not settled upon to attempt to prophecies.

I do not wish to be misunderstood: I do not claim that the bill before you is unconstitutional in any of its parts; I do venture to indicate, however, that congressional enactments much simpler in import than the one before us have been held unconstitutional by the High Court, recently and dramatically enough to be in the minds of all of us.

VI. WHY RISE THE LOSS OF APPROXIMATELY $1,000,000,000 PER ANNUM

The existing levies on corporate income are as follows:

1. The ordinary income tax, ranging from 12 1/2 percent to 15 percent (prior to 1924 at 13 1/2 percent), which, together with the tax on a consolidated income basis, and the surtax under sections 102 and 105, yielded $172,117,870 during the last complete fiscal year which ended June 30, 1925, and collections under which during the present fiscal year have been $257,787,842 greater than during the corresponding 6 months of the preceding year.

2. The capital-stock tax at the rate of $1 per $1,000 of declared valuation, which, at the $1 rate imposed under the 1924 act, yielded $91,598,121 during the last complete fiscal year which ended June 30, 1925. Collections at the higher
rate during the first 6 months of the current fiscal year have been $97,273,752, an increase of $3,108,172 over the corresponding period of 1935.

5. The excess-profits tax at 6 percent and 12 percent on income in excess of the amount fixed by the levy because of the capital-stock tax, at the 6 percent rate that is in effect, yielded $6,569,485 during the last complete fiscal year ended June 30, 1935. $10,000,000 was the estimated yield for the current fiscal year, per the 1935 report of the Secretary of the Treasury.

4. The surtax under section 102 for unreasonable or improper accumulation of surplus, at 25 percent and at 55 percent, and the surtax on "personal holding companies," under section 351, at rates ranging from 20 to 60 percent. The yield from these sources has not, as far as I know, been published separately, but it is undoubtedly available to the committee, as it is the estimate for the current year. 3 The levy is retained in a limited form, as it is also the surtax on "personal holding companies."

The total yield from all taxes on corporations for the last fiscal year which ended June 30, 1935, was $70,135,482; collections for the current year are running ahead of those for last year by approximately $181,000,000. (If business continues to improve, it is reasonable to expect corollary higher yields from the sources under discussion. Indeed, the Statistics of the Treasury has estimated that all corporate taxes for 1936, if the existing law remains unchanged, would amount to $1,352,000,000.

In considering the revenue bill, consideration must, of course, be given to the proposal that, save for the temporary retention of the capital-stock tax at half its existing rate and the temporary retention of the excess-profits tax, reasonably assumed income of over $4,000,000,000 is to be abandoned, in the belief that the complicated and novel measure under discussion will yield a permanently increased revenue of $220,000,000 per annum from the proposed taxes on undistributed corporate income and from the proposed increased income tax on dividends received by individuals, which are to become subject to the personal as well as to the surtax. The House has discussed the matter, while hesitating to criticize official estimates, of relying on estimates of yield from so novel a measure as the pending revenue bill.

I must suppose, that the Supreme Court were to decide that the new tax law is unconstitutional. Personally, I shall not argue with anyone who claims that the risk of such a decision is not imperceptible, nor do I suppose that anyone of competence would unqualifiedly assert that under no circumstances is it conceivable that the High Court might find the proposed bill unconstitutional. Whether the Schechter (N. R. A.) and the Triple A (Foods) decisions were wrong or not, the essentials of the particular setbacks enunciated by the House were determined by the decision of the Court. It seems abundantly clear that those who are charged with the responsibility of the administration of the law are in the position to bear the consequences of the result of such a decision. In fact, if I were judge, I should not at once proceed to show,

VII A SHORT SIGHTED FISCAL POLICY

Witnesses before the Ways and Means Committee have clearly indicated the difficulties of operating in the years of unemployment. The teaching of economics and corporate finance, the recognized sound doctrine.

Recently, the National City Bank of New York, on the basis of Treasury statistics, published on the basis of Treasury annual reported net income for all corporations amounted to $2,000,000,000. The average dividend paid during the period that averaged $5,000,000,000 per year was distributed included in the absence of net income or in amounts of the depression, the excess of such adjusted net income over dividends paid during the years during that period, were paid by corporations; that year, for example, the corporate income tax rate was 12 percent; without

VI. SAVINGS EXPERIMENTATION

If Congress decides that it really wishes to experiment with a general tax on undistributed income, two perfectly safe alternatives are available: (1) Extension of existing sections 102 and 351; (2) Continuation of existing taxes supplemented by a minor (experimental) tax on undistributed corporate income.

(A) Extension of existing sections 102 and 351—Under section 351 of the existing law, a surtax is levied on incomes of personal holding companies. This is in addition to the normal tax on the statutory net income of such corporations, levied at the rates applicable to ordinary corporations.

The statutory net income is adjusted in the manner clearly set forth in the law, and the excess of such adjusted net income over dividends paid during the years after a 20 percent reserve and a reasonable reserve to retire indebtedness incurred prior to 1934 is subject to a graded surtax ranging from 20 percent to 60 percent.
To the extent of the validity of the criticism directed against corporate management, namely that because a few stockholders are in control, income is permitted to accumulate unreasonably and unnecessarily, the definition of personal holding company could probably be modified so as to come into line with major abuses. Surely, if the criticism is predicated on the conduct of a relatively few corporations which are controlled by a handful of stockholders, that fact hardly justifies such radical change in our taxing system as is contemplated in the revenue bill. 

Section 102 of the existing law deals with more investment and holding companies regardless of the number of stockholders, and with other ordinary business corporations which are used or availed of for the purpose of accumulating unreasonable surplus. While it is understandable that the Treasury has experienced difficulty in enforcing the provision generally, except with respect to more holding and investment companies, I wonder if the ingenuity of those new charged with fiscal responsibility could not suggest more effective administrative provisions than those contained in the present statute. I suggest that officials of the Treasury and of the joint congressional committee be urged to make appropriate recommendations. For myself, I am not prepared to concede that enforcement of the principle of section 102 is impossible.

(1) Continuation of existing taxes supplemented by a minor (experimental) tax on undistributed corporate income. – If it is to be assumed that Congress is determined to experiment with a tax on retained corporate earnings, I suggest that the existing corporate taxes be continued; that if other alternatives are acceptable, a flat corporate income-tax rate be adopted slightly higher than the existing maximum graduated rates; that the normal tax be made applicable to dividends received by individuals; that the normal tax on individuals be increased by one or two percent, or that the specific exemptions be moderately reduced; and, in addition, that a very moderate, simple, and experimental tax be imposed on undistributed corporate income.

(3) Deductions to be allowed for capital losses not taken into consideration in the determination of ordinary net income, but in no event to decrease the ordinary net income by more than 15 percent thereof.

There may be some question as to the constitutionality of any levy on retained corporate income on the basis of the amount of such retained profits. The courts have held, however, that a tax levied on corporate taxpayers would survive judicial scrutiny, since it is not a tax on personal income but on income derived from a business enterprise.

X. SIMPLIFICATION OF THE REVENUE BILL

If Congress is determined on enacting a general tax on undistributed net income of corporations, simplification of the revenue bill should be sought, even at the expense of theoretical (but never completely attainable) equitability. Corporations and retain them with respect to individuals. Insofar as the revenue bill is concerned, however, the problems of the present series of income-tax laws. Perhaps the basis for acceptable compromise may be found in the following relative simple tentative proposals in which the suggested tax on retained net income is based on net income and specified deductions therefrom:

(1) Applicable to ordinary corporations without special problems:

(a) Deductions to be allowed for capital losses not taken into consideration in the determination of ordinary net income, but in no event to decrease the ordinary net income by more than 15 percent thereof;

(b) Deductions to be allowed for distributions of earnings taxable in part or not taxable at all; and

(c) Deductions to be allowed for dividends.

If the foregoing deductions are taken, the net tax will be equivalent to 12 1/2 percent of the amount of net earnings. Such dividends are not subject to any given rates, under existing law or regardless of the type of new revenue legislation which may be enacted, would unquestionably result in reduced revenues; the estimated loss need not be provided for by increased basic tax rates or otherwise, because of the probability

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The proposed provision for including among deductions item (d) accomplishes part of the evident purposes of section 14 more simply; it is also more equitable.

21. ENCOURAGEMENT OF CAPITAL DISBURSEMENTS

It is a trite observation that in the training of a revenue measure economic conditions should, as far as possible, be taken into consideration. Many observers agree that the continuance of the existing economic depression is due partially to the persistent volume of unemployment, and that unemployment is most severe and distressing in the so-called heavy or durable goods industries. In the endeavor of the administration to remedy this situation during the past 2 years, among the billions disbursed for direct and indirect relief, many millions have been spent to decrease unemployment in the heavy industries. Discounting adverse and unfriendly criticism and allowing for faulty labor statistics, it is nevertheless extremely true that improvement in these industries appears to have been commensurate with the amount spent by Federal, State, and local governments. I am too well aware of how history manages to ignore prophecy, whether optimistic or pessimistic, to assert without the utmost qualification that, in my opinion, democratic government is in danger unless business and industry cope successfully with this problem of unemployment. The question to be answered is: to what extent will the existence of effective cooperation? I offer for the consideration of the committee a proposal that disbursements for replacement of, and additions to, plant and equipment be, to a very limited extent and during a relatively brief period of time, permitted to decrease tax liability. The effect should be in line with Government policy. My tentative suggestion, primarily for consideration and discussion, is as follows: That, applicable to the tax year 1938, disbursements made (and not merely obligations incurred) for plant and equipment replacement and additions actually installed shall be allowed as a deduction from ordinary net income to the extent of 50 percent of the amount of the disbursement, but not in excess of 20 percent of the ordinary net income; that, applicable to the tax year 1937, such disbursements shall be allowed as a deduction from ordinary net income to the extent of 20 percent of the amount of the disbursement, but not in excess of 10 percent of the ordinary net income. I trust that no similar provision will be necessary, desirable, or expedient for the tax year 1935.

The suggested proposal upsets the tax rates, but the differences made (and not merely obligations incurred) for plant and equipment replacement and additions actually installed shall be allowed as a deduction from ordinary net income to the extent of 50 percent of the amount of the disbursement, but not in excess of 20 percent of the ordinary net income. I trust that no similar provision will be necessary, desirable, or expedient for the tax year 1937.

The suggested proposal and the tax rates, but the differences made (and not merely obligations incurred) for plant and equipment replacement and additions actually installed shall be allowed as a deduction from ordinary net income to the extent of 50 percent of the amount of the disbursement, but not in excess of 20 percent of the ordinary net income. I trust that no similar provision will be necessary, desirable, or expedient for the tax year 1937.
that improved business and increased employment in the heavy-goods industries would result in increased corporate and individual taxable incomes, and hence such prospectively increased employment would at least correspondingly reduce the Government's responsibility for emergency relief.

During the past 2 years, taxpayers have been permitted deductions for depreciation at substantially lower rates than those which were allowed therefore. The tax effect of this policy, as administered under Treasury Decision 466, which was promulgated on February 26, 1934, is indicated in the reports of the Comptroller of Internal Revenue for 1934 and 1935. From March 15 to July 15, 1934, a total of $215,000,000 of claimed depreciation was disallowed, resulting in an increased taxable income of $242,024,222 and recommended deficiency assessments of $29,609,904. For the full fiscal year 1935, the total disallowed for depreciation deductions was estimated at $233,681,628, and the resultant additional tax at $351,018,414, and the amount of such additional tax agreed to by taxpayers at $25,652,112. The slower depreciation write-off has undoubtedly tended to delay plant replacement. When a capital account on the books has been nearly written off, replacement reserves are correspondingly large and management is not as prone to hesitate to make replacements as when machinery still in use appears on the books at a relatively greater value. This procrastination in replacement has undoubtedly had some appreciable effect on increased unemployment in the capital-goods industries. The suggestion for temporary allowance of a limited part of the cost of replacement and additions is, in addition to the other reasons advanced, predicated on the existing depreciation allowance policy.

XII. FINANCING THE ACCELERATED BONUS

The President's message advised Congress that from $120,000,000 to $190,000,000 would be required annually for the next 9 years to amortize the cost of the recent bonus legislation; in the specific recommendation $120,000,000 was given as the figure. Speaking in what follows for myself alone, I feel that it is a fair assumption that the bonus legislation was enacted because Congress believed that there was an overwhelming, popular demand for it. If it is unthinkable that Congress should wish to have the electorate know exactly how much they contributed to its own end and by whom the burden of financing the cost of the bonus legislation is borne? If a direct tax is ever justified or expedient, the financing of popular legislation would seem to provide the occasion.

For this reason, I invite your attention, without recommendation, to the desirability of expeditions having the cost of the recent bonus legislation borne by popular subscription, as it were.

In this connection, I direct your attention to the fiscal possibilities of a tax on salt. Production of salt in the United States, during 1934, amounted to 7,612,074 short tons; a tax of 1 cent per pound would be equivalent to $132,241,460. Not all of the salt produced is of the table variety, of course, and the tax could be calculated as to be equivalent to 1 cent per pound on the refined product, and the resulting tax somewhat less than the figure given. A salt tax, if levied at the point of origin, would not create substantial administrative problems because the number of domestic producers, per the statistical abstract for 1933, is less than 100.

Naturally, any commodity tax which Congress might decide to impose would avoid the constitutional pitfall which proved the undoing of the processing tax.

Primarily for the purpose of reminding you of their tax potentialities, I shall also refer to three other commodities which, at least administratively, also lend themselves to simple levies. The domestic consumption of sugar during 1935 is given as 5,053,916 short tons. Much of this sugar is imported. If a tax of 1 cent per pound could be levied at the import point and, with respect to the domestic product, at the retail point, the yield would approximate over $55,000,000.

The import into the United States during 1934 amounted to 1,504,770,000 pounds. A tax of 3 cents per pound, administratively easy of collection if enforced at the points subject to tax, tax should also be taxable. The import of tea, about 85,000,000 pounds, while a tax of 20 cents per pound would yield about $17,000,000.

It must be stated that I do not believe that the tax on salt, sugar, and tea would be an adequate source of revenue to amortize the cost of the recent bonus legislation. The tax on salt would be much too small, the tax on sugar too small, and the tax on tea too large. The total amortization of the bonus legislation would require a tax of about $190,000,000 per year, and the taxes on salt, sugar, and tea, would amount to $190,000,000.

XIII. TREATMENT OF INTERESTING DIVIDENDS

In the 1935 act, by section 103 (b), 10 percent of dividends received by a corporation from a domestic corporation was made subject to the normal tax. In the same act, by section 119, the breaking of pyramid corporate structures was encouraged by permitting tax-free liquidations over a period of 5 years. In the bill under consideration, by section 27 (1) (4), intercompany dividends are subject to maximum taxes, even though the passage of the dividend to the parent unit is expedited and the top corporation makes immediate disbursement to its stockholders. Speaking for myself and not for my committee (which was not consulted about the matter), I feel that the inevitable result could not have been intended. Positive taxes directed against corporations frequently hurt innocent stockholders. I believe that the maximum change should exempt from the application of the subsection (1) corporate groups which are in process of statutory liquidation under section 112 (b) (4) of the bill, and (2) group intercompany dividends which are distributed to others than controlling corporations during the "dividend year" in which received. These corporate groups should not be forced to seek lawful means of escape, such as is indicated, for example, in section 27 (1) (3) of the bill.

XIV. SPECIAL PROVISION FOR AMERICAN-OWNED FOREIGN PRIVATE CORPORATIONS

It is no secret to the tax administration and to this committee that high taxes tend to drive to cover those taxpayers who can escape the tax collector. There are probably no available statistics relating to the number of Americans who formed or use foreign corporations for the primary purpose of lawfully minimizing or avoiding United States taxes. Under the existing law, upon the death of stockholders in such corporations, the estate is, in effect, wiped clean. Although I have not had an opportunity to poll my own committee on the matter, I venture to offer the suggestion that Congress might wish to permit the return of such American-controlled corporations under terms which would make it difficult to return, not too onerous, and thus bring within tax reach funds and transactions which otherwise would continue to remain lawfully immune from American process.

Something like analogous precedent for this suggestion may be found in the 1935 act, where the estate of a deceased owner was permitted to return foreign income which appeared in an account in the name of the deceased owner.

This section, as all of you, especially Senator Sterling, will recall, was intended to encourage the break-up of the pyramid corporate structure recently under criticism. My suggestion is to encourage the dissolution of American-controlled corporations. Two methods of accomplishing this are:

(a) Liquidation of the assets to American stockholders subject to a flat tax of, say, 12½ percent of the amount of gain realized, but with no allowance for corresponding losses.

(b) Transfer of the assets to existing or to newly created domestic corporations under conditions and restrictions similar to those in section 110 of the 1935 act.

The privilege referred to should be available during a very limited period of time, say 1 year from the enactment of the governing legislation.

XV. POSTPONEMENT OF REVENUE LAW TINKERING UNTIL THOROUGH SCIENTIFIC REVISED IS POSSIBLE

I believe it must have been made abundantly clear that the bill under consideration is not an ideal revenue measure. It is equally obvious that the proposal does not pretend to be a fundamental revision of our entire system of taxation. Our tax laws are in need of scientific and fundamental revision. It may or may not be feasible in the process of revision to cooperate with State taxing authorities. There are those who believe, however, that much may be done to extend the existing legislative and administrative cooperation between the Nation and the States.

For all of the reasons which have been advanced I venture to recommend:

(1) That the piecemeal tinkering implicit in the revenue bill be abandoned.

(2) That temporary emergency revenue, strictly limited to an essential and irreducible minimum, be provided for the current and for the next fiscal year through one or more of the following sources: Increased rates on corporate income, increased normal rates on individual income, reduced personal exemption, subjecting dividends received by individuals to the normal tax,

Regraded Unclassified
Senator Black. Is your business incorporated, or a partnership?
Mr. Lane. It is incorporated, a close corporation, with only about 75 stockholders.

Senator Black. What is the capital stock?
Mr. Lane. We have 10,000 shares of par-value stock, and our present capital is about a million dollars.

We started with a capital in the beginning of $18,000 and we added to it from time to time, until it got to about $180,000.

Between 1912 and 1915 if we had had to pay additional taxes on this business I think we would have gone broke, because we were just about a half a jump ahead of the sheriff all of the time, and under this proposed bill we would have had to pay $2,100 of taxes in that period, whereas we did not pay anything under the old tax law in effect at that time.

Senator Black. You are going back to 1912, there was not any corporation tax at all at that time?

Mr. Lane. I understand, that is correct, it was not until 1913, but the point I am trying to make, if we had had any additional taxes to pay, it might have rubbed us out.

Senator Black. If you had had that tax, you would have taken it into consideration in the profit on your commodities?

Mr. Lane. Well, Senator, I do not know how long it has been since you have been conducting a business of this kind, but if you have been, you know that it is the public that sets the prices.

We paid $1,200 taxes in that period, and the bank gave us all they could, we got every nickel we could by pledging all of the security we had, even using our accounts receivable, which is the last card a manufacturer has to get money, and by putting mortgages on our property.

We have a lot of customers who are today in the same fix.

In 1912 to 1918, which covers a greater period, our company made a profit of $35,000.

Senator Hastings. During the first 7 years?

Mr. Lane. Yes, sir.

Senator Hastings. $35,000 for the whole period of time?

Mr. Lane. Yes; and paid out approximately 10 percent of that, or some $3,500.

Senator Hastings. For what?

Mr. Lane. For dividends, and we paid out approximately the same amount in taxes, to be exact, $2,000 paid in taxes during that period. Under this new bill, we would have had to pay $12,500 or 35.7 percent of all of our earnings in that time.

Senator Hastings. You mean on the profit you made of $35,000, as you understand this bill, you would have had to that tax?

Mr. Lane. Yes, sir. I would like to say there are some provisions in this bill for companies who have fixed debts and that kind of thing, that, which I dare say, figures out better, but we do not understand how it would be.

Senator Black. Would you mind putting down the profit you made each year so that we could have it figured out, because if I understand the bill it would not have been that much tax.

Mr. Lane. I will be glad to put in those figures.

Senator Blackley. Your figures are before or after you paid the stockholders?
Mr. Lane. From 1912 to 1918 we paid out 8.6 percent of our earnings in dividends, and the taxes amounted to 8.3 percent for the same period, so that the Government got approximately as much as the stockholders did. But under this bill it would be approximately 35.7 percent paid out in taxes.

Senator Barkley. The tax of 35.7 percent was on the total that remained in the corporation; you did not pay a corporation tax on what you distributed to your stockholders, although they may have paid it.

The Chairman. They paid this on the profits of the corporation.

Senator Barkley. Back in 1918?

Senator King. As I understand, this is 1912 to 1918.

Mr. Lane. That is correct.

Senator Black. Would you mind putting down the figures of the profit for each year so that we can figure that out on what you reserved? I believe you said you made $35,000 in that period.

Mr. Lane. Yes, sir; from 1912 to 1918.

Senator Black. Do you have it by years?

Mr. Lane. I can furnish it by years, but I haven't it here except in bulk.

Senator Black. Do you have your net income for each year there?

Mr. Lane. No, sir; not here. I just brought some bulk data that I thought we could use, and you would like to see.

Senator Black. Was it about even each year?

Mr. Lane. No, some years we had a loss and other years we made money.

Senator Black. You kept all of this in your business?

Mr. Lane. Yes, we kept all of that $35,000 in the business, except $3,096 paid out in dividends, and $2,997 we paid in taxes.

Senator Barkley. Let me see if I have that correctly. Thirty-five thousand dollars is the profit from 1912 to 1918, annually?

Mr. Lane. No; that is the total profit for the entire period, and the point that is worrying me about our accounts is that when a concern is young, trying to go ahead, it needs every bit of strength it can get, and this bill will sap the strength away from them. We have had competitors that lost a lot of money in the depression, practically lost all of their working capital.

The Chairman. How would it sap your business?

Mr. Lane. Mr. Chairman, it was taking something over one-third of the money we made, whereas it only took 8 percent in the old tax situation, and to show we are not making anything out of it we did not pay any dividends to amount to anything in that period.

The Chairman. How much are you earning now, what is your profit annually?

Mr. Lane. It fluctuates, of course. Last year, I think, according to the way the Internal Revenue Department figures it, we earned $180,000 net.

The Chairman. Did you declare any of it in dividends?

Mr. Lane. Yes, sir; we paid approximately one-third of that in dividends.

The Chairman. Do you think it would have hurt you if you had paid out 30 percent and retained 30 percent?

Mr. Lane. Mr. Chairman, I will answer this way, last year we spent about $80,000 in improvements in our plant, and this year we are planning to spend $110,000 in improvements. We could use our reserve to increase working capital, but we would have to become static in capital, and could not grow any more, as we see it. I cannot understand this tax bill and I have had lawyers, tax experts, and everybody else try to explain it, and I cannot understand it at all.

The Chairman. Suppose five people owned this plant of yours, and it was a partnership instead of a corporation, they would have to pay on their individual incomes, would they not?

Mr. Lane. Yes, sir.

The Chairman. How do you distinguish between them? If a corporation should pay some amount, why should favoritism be shown a corporation as against an individual?

Mr. Lane. As I understand a copartnership, as a rule there are not very many partners, and they can get together and decide what they want to do for the good of the business, but we are just trustees of some property as managers of the corporation, and we have the stockholders looking to us to look after their interests, that never come to a meeting even.

The Chairman. From governmental standards why should a corporation be put under more favorable circumstances than a partnership when it comes to collecting taxes?

Mr. Lane. Mr. Chairman, I should have said, to start out, that I am just a businessman. I am not an expert like Mr. Klein, and I did not come up here to tell you what kind of taxes to put on, nor to oppose this scheme of taxation. Mr. Lawson, our vice president, knows more about taxation that I do.

The Chairman. Does it not appear to you as a layman that it is a fair thing from a governmental standpoint that a corporation should not be put in a more favorable position than an individual in paying taxes?

Mr. Lane. Yes, sir; I think so, from a layman's viewpoint.

The Chairman. That is all that is being done here.

Mr. Lane. Yes; but I wonder if it could not be accomplished without putting such a burden on the small corporation. A gentleman read this morning a list of 10 corporations who would not pay any taxes, and the stockholders would not pay any more tax than the 4 percent you are putting on the corporation dividends.

I know some tobacco corporations last year and the year before who paid out more than they earned during those years, and you are going to leave them without any taxes at all, and you understand what I am interested in is the small corporation struggling along that is looking for all that it can get to keep going.

The Chairman. We are going to give you an amount of reserve and there will be no higher tax on that than you have been heretofore paying, if you analyze that situation.

Mr. Lane. As we analyzed it, Mr. Chairman, this tax as now proposed is going to double our taxes for 3 years over what they were for 1935, on the same earnings.

Senator Black. Double whose taxes?

Mr. Lane. Double our corporation tax.
Senator Black. Not the little company, but the company as it is now.

Mr. Lane. Yes, sir.

Senator Black. As a matter of fact, you have figured out enough to know at the time you are talking about your company being small, it would have gotten out on a much smaller tax than the 15 percent.

Mr. Lane. No; I have not figured that out.

Senator Black. Yes; that would be true, and it would be better for the small corporation.

Mr. Lane. The less tax they have to pay, the longer they will survive.

Senator Connally. How does your company handle the income that you expect to retain as reserve on surplus?

Mr. Lane. I think I can answer that question best by what we have done.

Senator Connally. I am talking about the experience of your company.

Mr. Lane. I will give what we have done in the disposition of our earnings.

Since we have been in business, since 1912, 29.9 percent of our earnings since we started in business has been reinvested in fixed assets.

Senator Connally. If you do that in the future, you will not pay any more tax than you do now, because you retain 30 percent in surplus and reserve, and you will then no pay as much as you do now.

Mr. Lane. I am not a sufficient financial expert to say, sir.

Senator Connally. All right, you may go ahead.

Mr. Lane. As I say, 29.9 percent reinvested. It took 25 percent more of our earnings to increase fixed capital to take care of the production that the increase brought about. So that there is approximately 53 or 54 percent that it took of our total earnings during that period for improving conditions of the plant and increasing net working capital.

Senator Connally. How much do you figure you would pay if you did that under this bill, say, if you take 50 percent of the earnings and distribute it and keep 50 percent?

Mr. Lane. I cannot answer that. I can only say the earnings last year were $160,000.

Senator Barkley. If you keep $80,000 and pay out $80,000 under this bill, how much would the tax be?

Senator Connally. Mr. Kent, can you figure that out? While Mr. Kent is doing that, Mr. Lane, just go ahead and state what the capital of your company is.

Mr. Lane. It is approximately a million dollars.

Senator Connally. And you made $160,000?

Mr. Lane. Yes, sir.

Senator Connally. That is a very good profit, 16 percent.

Mr. Lane. Yes; but we have got to look back to 1922 and 1933.

Senator Connally. We are out of the woods on that now.

Mr. Lane. No, I don't think so; but if so, while we are out of the woods now, we are looking for the next depression.

Senator Barkley. You are looking for the next depression?

Mr. Lane. Yes, sir. We paid out 31.8 percent for dividends, and I think that answers your question of awhile ago. We have paid out 32 percent in round figures of our profits in dividends since we have been in business, but mind you, 84 percent of what we have paid out has been in the last 12 years of our life, or about one-half of our entire life of 24 years.

Senator Barkley. How many stockholders did you have when you first organized?

Mr. Lane. When we first started we had two, my father and myself.

Senator Barkley. As your business grew your neighbors and friends bought stock?

Mr. Lane. Yes; we pleaded with them to help us out.

Senator Barkley. Your stock is not registered on the stock exchange?

Mr. Lane. No, sir; it used to be registered at Richmond, but when the Securities Exchange came in, we dropped it, so as not to be bothered with the making the reports.

Senator Barkley. There is not much trading in your stock?

Mr. Lane. Very little.

The Chairman. Suppose you and your father had continued this business as partners when you first started, have you figured out how much tax you would have paid as individuals, as compared with what you would have to pay under this bill?

Mr. Lane. No, sir; I have not.

The Chairman. It would be a greater amount?

Mr. Lane. I presume it would be from what I have learned from copartnership arrangements. But my judgment is that could be corrected. It would seem to be it is important for a corporation to have a good start, because the point I am trying to stress is from my own experience, Mr. Chairman, how utterly necessary it is to keep every penny you can get hold of in your embryonic years as a corporation.

The Chairman. Yes; you have got to keep some money in the business, you have got to enlarge, but if it is a copartnership and they are paying taxes much higher than the corporation, and what we are trying to do is to put them on an even keel.

Mr. Lane. I think it is an unfairness that should be corrected in some way, but I am not sure the present one is the way to do it, since we calculate that in 1918 our company would have passed out of the picture if we had been compelled to pay taxes on the basis set up in this proposed bill.

Senator Connally. Mr. Chairman, Mr. Kent has those figures now.

The Chairman. Will you state the result of what you have figured?

Mr. Kent. Since the corporation here was realizing a net income of $10,000 or less, if it retained 50 percent of its adjusted net income it would pay a tax at the rate of 18.5 percent; 31.5 percent under those circumstances would be distributed in dividends to the shareholders.

The Chairman. Eighteen and five-tenths percent of what was distributed.

Mr. Kent. Eighteen and five-tenths percent of its net income.

The Chairman. Its net income was how much, did you say?

Mr. Kent. Say they had $10,000 of net income, they retained $5,000 in surplus, and they would pay taxes of $1,850 and would pay out dividends of $1,150, and when they get into the higher income groups between $10,000 and $40,000, under schedule 3, there is a
somewhat different rate, and after they get past $40,000 they would pay 35 percent.

Mr. LANE. We earned last year $160,000, and retained half of that; how much would the tax be on the rest?

Mr. KENT. If my arithmetic is correct, it would be about $50,000; but that does not take into account there are other means of keeping the money without paying the maximum tax.

Mr. LANE. That still leaves us where we cannot learn much about the law from the study we have been doing since the President suggested it and since we got the first report from the Ways and Means Committee.

Senator CONNALLY. This $160,000 profit you made, was that after depletion, amortization and all of that figured off?

Mr. LANE. Yes; that is not profit.

Senator CONNALLY. For income-tax purposes?

Mr. LANE. Yes, sir.

Senator HASTINGS. Was it after the taxes were paid?

Mr. LANE. After all taxes, but no dividends.

Senator HASTINGS. You did not deduct the income tax from that?

Mr. LANE. No, sir. In this connection I might say our books do not agree with the Internal Revenue Department, because they do not allow us to count off taxes the depreciation we have. Our experience shows us we have an obsolescence factor in equipment from the standpoint of style changes, of which we have had four in 24 years, but they will not recognize those things we think should be recognized.

The CHAIRMAN. Is that due to the peculiar styles of furniture?

Mr. LANE. Yes, sir; that is correct.

Senator KING. You are not making any solid furniture?

Mr. LANE. Yes, we do; but we are specialty manufacturers, making primarily cedar chests.

The CHAIRMAN. You will admit you make as good furniture as any other manufacturer?

Mr. LANE. Yes; of course.

Senator BARKLEY. You do not make any antique furniture?

Mr. LANE. Not much, but we have a set of furniture, a duplicate of the Mount Vernon furniture, but that is high-priced furniture, and we do not make any money out of it. Our cedar chests, on account of being nationally advertised, we can get a volume of production on it and can make some money on it.

The CHAIRMAN. If you want to, one of the experts on this proposition of figures will be glad to cooperate with you and tell you everything about it.

Mr. LANE. I think we have learned a lot today, gentlemen, but I want to say this: We know that twice during our business career, 1918 and 1922, if these taxes had been in effect we would have been totally insolvent, because the taxes proposed under this bill appeared to us to be three and a half times what they would be under the old law that existed at that time.

Senator CONNALLY. If you had been a partnership instead of a corporation, you would have been "busted"?

Mr. LANE. I think so.

Senator CONNALLY. What about the individuals that are partnerships and paying the higher taxes? You have been getting off with a lower rate than you would have if you had been an individual or partnership?

Mr. LANE. They have a perfect right to organize a corporation any time they get ready.

Senator CONNALLY. Yes; that is correct.

Mr. LANE. That is what I would do; I would never operate a personal business instead of a corporation.

Senator CONNALLY. You have paid less taxes because you were not a partnership.

Mr. LANE. Yes; there was no corporation tax when we organized.

Senator BARKLEY. There are other advantages of organizing as a corporation, because you are only liable to the amount of your stock.

Mr. LANE. Yes; and we were glad from 1912 to 1922 that we were a corporation. I heard the statement this morning—that if we wanted to keep our profits in our business we could offer stock rights and things of that kind to our stockholders. That might sound like a remedy, but in between 1912 and 1922, if our stockholders had ever gotten hold of any of our earnings as profit they would have taken them and run with them; they would never put them back into the business. If I could have gotten half of mine at that time I would have said to the creditors, "You can have the rest of it."

You must understand the small corporations have no access to the capital markets when they can only get money by selling stock to friends and borrowing from the banks and things of that kind, and under this bill I don't see how a small corporation ever can get anywhere.

The CHAIRMAN. But you are pretty much out of that class now.

Mr. LANE. We just claim we are green country boys trying to make a living.

Senator HASTINGS. Would you mind telling how many shares the largest stockholder holds in that corporation?

Mr. LANE. I own the largest number—35 percent of 10,000 shares.

Senator HASTINGS. Are you engaged in any other business?

Mr. LANE. No; this keeps me plenty busy; and during the last 3 years I have been kept busier than I want to be, because we have to look after our business and watch Washington all at the same time.

Senator BARKLEY. And you do not want Washington to exercise the same supervision over you?

Senator BLACK. You say in the last 3 years you have been watching Washington?

Mr. LANE. Yes, sir.

Senator BLACK. You did not have time to watch Washington in 1932?

Mr. LANE. I had more time than I have had more time than in a long while recently, and I could play golf in those years, but not the last couple of years; I haven't had time.

We talked this matter over with a concern in Lynchburg, and took his figures and projected them since he started in 1916 with the figures under this proposed tax bill. We do not claim it would have put him out of business, but at times he would have had a heavy squeeze.

In 1912 we started working 12 men, and today be work about 500, and over 400 in the plant. We figure if this tax had been applied
we would have been working about 250 today—just about half as many.
If we had not had working capital in 1931, 1932, and the early part of 1933, we would have discharged half of the employees we had and cut the wages of the rest of them as much as we could and tried to make some money in those years, but we did have working capital and we kept all of our people on, except only those who dropped out of their own accord and we did not take back. We worked them short hours, sometimes 12 or 15 hours a week; we took our loss, but tried to keep those people busy. If we had not had working capital we could not have done that.

Frankly, when we projected this little expansion program last November and December which we are working out now, if I had dreamed then this new tax bill was contemplated, I would not have put on this expansion program. We just bought a machine yesterday, a big triple-drum sander from a concern in Wisconsin.

Senator Connally. You bought it yesterday, when you knew about this bill?

Mr. Lane. We had the building all ready, and we had to put something in it. They told us that is the third machine they have sold in 12 months.

Senator Black. Did they tell you how many they sold in 1932?

Mr. Lane. I presume they did not sell any, and probably they took some back.

The Chairman. Business has improved in your line of business, however?

Mr. Lane. I think it has improved, but the capital-goods industry has not improved yet, with the exception of a few.

The Chairman. That is the general impression, that business is improving.

Mr. Lane. That is true. Frankly, I am not here throwing rocks at anybody; I have been a Democrat all of my life, but if you could get off our backs for a while, quit threatening us with all types of legislation, and let us see where we can go, we will be a lot better off. I will be so glad when you fellows adjourn, which I hope will be next month.

Senator Barkley. You would rather we would adjourn before we pass this tax bill?

Mr. Lane. I surely do. This new law to us seems a provision against plowing back the profits into the business. It will seriously injure the capital-goods industry, as a large percent of the business they get is the result of profits being used to expand business facilities. If this act is passed in anything like its present form, then credit should be allowed against profits used in increasing facilities, and we believe that ought to be done if it could be made workable.

Of course, you realize when you increase taxes you are transferring spending power from individuals and business to the Government. The more you tax the less individuals and private industry people, because we haven't anything to employ them with.

I am just giving you as a layman the businessmen's point of view, and I appreciate your attitude, because you are not treating me very rough.

We believe a good deal of the suffering of the last depression was due to income taxes. By business in the last 20 years, because history teaches us we have fat and lean years, and if we do not lay aside for the lean years when business is good in the fat years, we will be put out of business in the lean years.

If it is politically impossible to enact a sound basis of taxation from an economic standpoint and you feel it is necessary to increase the Government's revenue through taxation, then why not continue the present basis and increase the rate to the amount absolutely necessary to be raised, then we can calculate, as we already know how much reserve we have to set aside to meet those taxes.

The Chairman. Have you any idea how much we would have to increase the flat corporation tax in order to raise the money we have to raise this year?

Mr. Lane. I have not figured that out, but if your tax is, roughly, 15 percent, if you raise it to 30 you ought to double it. I don't know how much you would lose in the shuffle, because the higher you raise it the more ways will be found to evade it.

If you increase it 5 percent, you will increase it a third; then if you want to tax the surplus, or make an experimental tax like Mr. Klein suggested, I think it would be a good idea.

It seems to me unsound to try to trade a certainty for an uncertainty. You know how much revenue the present taxes will raise, and you can estimate quickly how much a certain increase in the present tax will yield. The Treasury Department can estimate what the taxes will yield on the basis of 1934.

This tax closely approaches, if it does not actually reach, confiscation.

In other words, you are under this bill eating the seed corn. I have always thought that all of us have just learned how to make out the old returns and the law has not been radically changed enough that we cannot still have lawyers and tax experts to make out our returns, but on this new bill I have had lawyers and experts figuring it, trying to find what our tax would be on last year's income, and no two agree about it. This is the most complicated thing ever suggested in the history of the world on taxation, and I defy any man in Congress, as he goes along in the year, to figure within 25 percent of how much he will have to set aside for a commitment on this tax.

The Chairman. You could do that in December.

Mr. Lane. Yes; but the year is over, and supposing you have spent something in improvements. At the present time we can tell how much taxes we have to set aside each month.

Senator Barkley. You do not have to estimate the amount of taxes until the tax year has passed, and you have 3 months in which to figure it all out before you make out the return, and it is the same proposition, depreciation, depletion, bad debts and all of that is involved in the present law, so that you have to go through the same tabulation to arrive at your net income under this bill, as you do now.

You may be able to get some additional credits under this bill that you do not get now, but after you have arrived at your net income for the year, then the only question is how much you are going to distribute, and when you have decided how much you are going to dis-
tribute, then you do not have to worry about the part you distribute, you only worry about the part you keep.

Then, there is no more obligation on what you keep than there is at the present time.

Mr. Lane. I do not see as a practical business man, myself, how we could tell as we go along during the year what your tax will be.

Senator Barkley. You cannot do it now.

Mr. Lane. Yes; we can estimate it closely now.

Senator Barkley. You do not know how much the income for the year will be until the year is over?

Mr. Lane. But we can take the profit each month and multiply it by the number of months, and come very close to it.

Senator Barkley. You have got to arrive at your taxable income after the year has passed and you have gotten all of the credit you think you are entitled to. In the first place, you file the income tax according to what you think; then they come along and check it up, and maybe you do not agree, but finally it is settled. The complications in making out an income-tax return, it seems to me, will not be greater than they are now; and one advantage, you only pay one tax, you haven't got to worry about all of the other taxes you pay now.

Mr. Lane. As I said, we have got to the point where we can estimate what our taxes are for the year by multiplying by the earnings to date, and under the new bill you cannot tell until the end of the year what it will be.

Senator George. Your position is you are doing business all of the year, every day, and you are not watching for the end of the year to get your tax return?

Mr. Lane. Yes; and suppose we pay quarterly, like we do, and we pay dividends; then if we haven't got money enough to pay the tax, what can we do?

The Chairman. There is a provision here that you can have them carry it over if you pay out too much.

Mr. Lane. Yes, sir.

Senator Byrnes. You say you earned $100,000; suppose you invested that $100,000 in new plant, how much tax would you have to pay then?

Mr. Lane. We would have to pay as much as if we had kept the cash, as I understand it. As we go along during the year, if we need money for fixed assets, in order to make a certain style of chest and to take care of any supply of chests, we cannot determine how much money we will have for that purpose without changing our current position.

Senator Byrnes. One other point, one of the last points made here, prior to the passage of this bill a corporation may have contracted to build a plant, and in your circumstances you had contracted to build a plant, and invested the $100,000 of your earnings for this year, then you would pay 42 percent taxes.

Mr. Lane. Yes; clearly that comes down to us this year, in that we earned $100,000 last year, and we had enough money in our working capital position to pay out $110,000 and still be reasonably comfortable during the spring season, when the business is not as much as it is in the fall, and pay for our improvements, expecting we could take all of this year's profit we needed except the 15-percent income tax and pay for the improvements and replenish our working capital position.

That is why I say if I had known this law was going to be offered I would not have made these improvements.

Senator Barkley. Suppose I owned a factory that has made $100,000 a year profit, as an individual, and I wanted to build a new plant, and I put that $100,000 in a new plant, I would have to pay taxes, I take it, in the $100,000 bracket, would I not?

Mr. Lane. Yes; and I tell you if this tax bill goes through, I wish you owned the plant.

Senator Barkley. And that bracket would be higher than you pay as a corporation?

Mr. Lane. That is true, as I understand it, but do you believe, if you are conducting a business of this size under the present conditions, you would conduct it as a copartnership?

Senator Barkley. No; I would not, but there are people who do.

The Chairman. Mr. Lane, you made those contracts you referred to prior to March 3 of this year?

Mr. Lane. We signed the contract January 15 of this year.

The Chairman. Then this bill helps you out on that proposition.

Mr. Lane. We did not go into it without money.

The Chairman. This is on the money you made last year.

Mr. Lane. But I cannot replenish my working capital position under that.

There is one other thought I would like to give you. We believe the principle upon which this new corporation tax law is based is absolutely unsound. In the first place, the Government takes upon itself the responsibility of conducting the business by reason of its earnings it must pay out in dividends or suffer the penalty, without at the same time assuming the responsibility for the damage such action might cause to the business in the future.

In other words, the Government assumes the prerogative of management without assuming the responsibility for results.

The Chairman. Thank you very much, Mr. Lane.

The Chairman. The next witness is Mr. Paul H. Wilson, of Worcester, Mass.

STATEMENT OF PAUL H. WILSON, REPRESENTING THE GRATON & KNIGHT CO., WORCESTER, MASS.

The Chairman. Mr. Wilson, can you get through in 15 minutes?

Mr. Wilson. Yes, sir.

The Chairman. You represent the Graton & Knight Co.?

Mr. Wilson. Yes, sir.

The Chairman. What business are they engaged in?

Mr. Wilson. The tanning of hides, fabricating hides and leather, leather belting, and leather products.

The Chairman. If you have a brief and want to put it in the record, you can point out the main points to us, if you want.

Mr. Wilson. I am secretary and comptroller of the company and have been with this company for 27 years. I have been secretary of the company since 1926.
I am appearing before this committee at my own request and on behalf of the Graton & Knight Co. The purpose of my coming here is to point out to this committee the ill effects the proposed tax law will have upon this corporation. Under the provisions of section 18, the Graton & Knight Co. will be required to pay a tax of 2 1/2 per cent on its income, which is an increase of 50 per cent, which increase is an undue hardship under the present conditions.

This company was organized in 1851 and has been doing business continuously since that date. Its business, as I have said, is the tanning of hides, manufacture of leather belting and leather products.

Our present capitalization as of January 1, 1906, is as follows:
- Preferred stock, 20,045.6 shares, $20,045,500; common stock, 88,229 shares, $1,027,875; surplus, paid in and earned, $711,112.40; making a total of $3,855,547.40.

Our outstanding preferred stock, consisting of 20,045.6 shares, is held by 1,305 individuals, averaging 15.7 shares per person.

Our outstanding common stock, consisting of 88,229 shares, is held by 1,732 individuals, with an average holding of 51.0 shares. The stock of the Graton & Knight Co. is widely distributed.

In addition to the preferred stock and common stock outstanding, the company, after it was reorganized in 1926 issued bonds of $1,750,000, of which $1,148,500 are still outstanding. The indentures securing the bonds provide for an annual sinking fund of $75,000.

The company at the present time employs approximately 1,000 people, does business in every State in the Union, and has a small factory in Shanghai, China, and branches in Canada, England, India, and dealer representations in other countries of the world.

The company had a very prosperous period through its entire existence up to and including the year 1919. To that time the company distributed large amounts in dividends yearly.

During the World War our company had large contracts with the United States Government for the manufacturing of war materials, such as shell cases, gun slings, holsters, and many other articles. At the request of the United States Government, we expended large sums of money during the war years in the erection of buildings and the purchase of large quantities of leather and other supplies for the production of war materials. Immediately after the close of the war we had a plant capacity far in excess of our needs, and a large inventory of leather and supplies purchased primarily for war purposes.

At the end of the year 1918 we had an inventory valued at $11,001,661.98 and were indebted to banks and other parties for borrowed funds in the amount of $6,148,500. During 1919 we did not suffer due in part to reduced sales volume, but mainly to receding prices on raw materials, most of which were purchased during the war, $4,968,000, a total of $7,650,000.

Our deficit at the end of 1921 was $3,567,000. Dividends were paid during 1920, but early in 1921 dividends, after one payment, were discontinued on the common stock, and only three quarterly dividends were paid on the preferred. No dividends have been paid on the common stock since 1921. A portion of the 1921 dividends were paid in scrip.

During the years 1922 to 1925, inclusive, the company earned about $625,000, and these profits, together with the cash realized by a reduction in inventories, was used to liquidate the company's indebtedness.

In 1927 the company succeeded in putting a bond issue, the proceeds of which were used to pay off bank loans.

Senator Kino (interposing). May I interrupt you at this point, Mr. Wilson? Had you redeemed the first issue of bonds, the $700,000?

Mr. Wilson. This is the same issue that I am referring to. They were issued in 1927.

Senator King. I see.

Mr. Wilson. The terms of the indenture were very strict and rigid. In that indenture we agreed at all times to maintain a certain amount of net tangible assets. These terms, we were told, were necessary in order to sell the bonds. At the present time we are in technical default on these bonds, because of this particular section, in the amount of $710,000. We have not been asked to redeem them, but we are not able to maintain a certain amount of net tangible assets.

Because of the terms of the mortgage indenture, the company cannot pay dividends, as its earnings are required to meet the sinking fund and other provisions of the mortgage, yet under section 15 the tax on its earnings is at the rate of 2 1/2 per cent. Under the present law the tax would be at the rate of 15 per cent or less, and this increase of 50 per cent on the present tax is a further burden on the corporation which is trying to keep going ahead. I believe also that this section 15 should be further clarified so that Graton & Knight Co. and other corporations in similar situations would be sure to obtain relief under the section.

Our bond indenture does not specifically state that we shall not pay dividends but does state that our assets shall be maintained at a certain fixed amount as long as any bonds remain outstanding and unpaid. This provision prevents the payment of dividends. A failure in the payment of sinking funds would constitute a default under the terms of the mortgage, and the rights of all stockholders would be in jeopardy.

Senator King. Have you maintained your sinking fund since the bond issue?

Mr. Wilson. Yes, sir.

Our company is one whose earnings are seriously affected by market prices of raw materials, namely, hides. During the past 10 years we have seen some very violent fluctuations in the prices of hides. Our inventories have always been taken on the basis of cost or market, whichever is lower, and due to these wide fluctuations in high prices, our inventory losses in the past have been large. On the basis of our present inventory a difference of 1 cent per pound on hide prices is equivalent to approximately $140,000 on our total inventory, which at present is approximately $3,000,000.

Senator King. You mean the personal property amounts to $3,000,000?

Mr. Wilson. That is the inventory itself.

Senator King. All of your assets?

Mr. Wilson. No, sir; all of the inventory, including hides and leather in the process of tanning. I might say, that is, on the first
of the year the price of steer hides was 143/4 cents; today it is 13 cents. That reduction has wiped out practically all of our earnings for the year 1933.

The CHAIRMAN. You cannot hedge?

Mr. Wilson. It is rather risky.

The CHAIRMAN. You do not practice it.

Mr. Wilson. We do not.

We have had the unfortunate experience of having hide prices drop very suddenly at the end of the year, which has resulted in large inventory losses for us, compelling us to show losses for the year, and large profits for the succeeding year, simply because we have had to price our inventories on the basis of cost or market, whichever was lower. In the year 1933, because of this condition, we showed a loss of $925,000, whereas in 1933 our profits amounted to $401,000. A large part of the profit in 1933 was due to the increase in hide prices.

The CHAIRMAN. What was it last year; did it show a profit or loss?

Mr. Wilson. Last year we showed a profit of about $211,000.

The CHAIRMAN. What was it in 1934?

Mr. Wilson. As I remember, we lost about $200,000 in the year 1934.

Senator King. And in 1935?

Mr. Wilson. We made about $211,000, after setting up a reserve for taxes of about $40,000.

The CHAIRMAN. It has been the character of your business to fluctuate from one year to another?

Mr. Wilson. Yes, sir.

Senator King. Is it your position it is your problem to build up your reserve rather than pay dividends?

Mr. Wilson. Yes, sir.

Senator King. So that any tax levied upon that reserve or surplus is especially injurious in your opinion?

Mr. Wilson. We believe so.

Senator King. And if you had a deficit you would be in greater default with respect to the obligations on your bonds?

Mr. Wilson. Yes, sir.

Senator King. You might even be forced into bankruptcy any minute?

Mr. Wilson. Yes. We felt we were faced with such a condition in 1932.

Senator Connolly. But in such a year you would not have any taxes on net income?

Mr. Wilson. But we could not build up our reserve.

Senator Connolly. But you would not have a reserve where you had a deficit?

Mr. Wilson. For the preceding year.

Senator Connolly. This only deals with current income.

Mr. Wilson. But if our reserves are exhausted, we feel we must build them up in order to take care of future contingencies.

The CHAIRMAN. Do you feel you should take care of all of them out of your net earnings?

Mr. Wilson. No, sir.
With our present situation I doubt very much if we could do this again if we had another emergency like the depression.

Due to the inventory losses, which we may have in the future, and to the terms of our bond indenture and to our shortage of working capital, the proposed tax on undistributed earnings of corporations will prove a serious hardship to us. A 23 1/2 percent tax on undistributed income as compared with the present approximately 15 percent would increase the tax payable to the Government 50 percent, as stated. We believe that such a tax would be extremely unfair to us.

Furthermore, in the event of an expansion of business whereby the company will have increased inventories and accounts receivable, the company will require all its earnings in order to have sufficient working capital to operate.

Due to the condition which the Graton & Knight Co. is in, the net earnings will be needed for working capital. Such working capital will not be in the form of cash, but in new equipment, inventories, and accounts receivable. The corporation does not have any excess cash and has no investments in securities which can be turned into cash, and is not in a position to make a cash distribution to the stockholders.

The money is needed in the business.

While I represent Graton & Knight Co. alone, yet I believe there are many other corporations in a similar position to the Graton & Knight Co.

We realize that the Government must have income, and one of the principal sources of revenue is the taxation of income of corporations. However, I believe that the Graton & Knight Co. and other companies similarly situated should not have any increase in the rate of tax under these circumstances. Unless we work out from under this default our tax rate would immediately step up to 42 1/2 percent; if we do get relief under the law, our rate would be 23 1/2 percent, and even at that I doubt very much if we would be in a position to resume dividends.

Senator Walsh. You are not paying preferred dividends?

Mr. Wilson. No, sir.

Senator Walsh. Since what time?

Mr. Wilson. 1931.

Senator Walsh. And you are not paying any dividends on common stock since then?

Mr. Wilson. 1921.

Senator Walsh. Are you meeting interest on your bonded obligation?

Mr. Wilson. Yes, sir.

Senator Walsh. About how much a year is that?

Mr. Wilson. About $115,000 a year.

Senator Walsh. Did you say how many employees you had?

Mr. Wilson. About 1,200.

Senator Walsh. You said you had not reduced wages since N. R. A.?

Mr. Wilson. That is right.

Senator Black. Do your employees still work the same hours?

Mr. Wilson. No, sir. During 1933, in the middle of 1933, when the company improved to the point where we could work our employees 40 hours. At the present time they are working about 36 hours.
thought to the committee that we take the present tax law as it applies to corporations and individuals, leave the law as it is, and add a percentage to the tax paid by every corporation and individual in order to help the Government over the present crisis.

Senator Rixey. What do you think of my suggestion—that of increasing the corporate tax up to 15 percent on income over $40,000 and then increasing the income tax upon the individuals, the normal tax, from 4 percent to 5 percent, and then a gradual increase in the surtax, particularly reaching those incomes of from $20,000 to $50,000, and then on up into the higher brackets, and raise about $600,000,000 in that way, and maintain the present tax structure?

Mr. Wilson. I am not in a position to discuss the surtaxes or the higher brackets, but, as a businessman, I believe the businessman today would favor an increased tax rate. I believe that the individual paying the normal tax also should have his tax raised. I believe the tax should be passed along to everyone. Incidentally, I believe that if Congress would give the business encouragement of that sort and other encouragement, that the businessman would be willing and ready to go along and that business conditions would improve through an increase of the tax rate. I believe that the businessman should be assured that Congress pledge itself to operate or to conduct itself as economically as it possibly can in the wise expenditure of money, as I believe you will get the cooperation of the businessman. I believe the businessman today feels Congress is antagonistic to him, and I believe the majority of business men in this country are just as loyal citizens of the United States as any other class of citizens.

Senator Walsh. Will the experts inform us how much increase there will have to be in order to meet the amount of money required under the bill; what would be the increase in the rate of corporation tax?

Mr. Kent. If the increased amount were gotten under the corporate banks, it is estimated it would have to be about 25½ percent; that is, an increase of about 10½ percent in the present rate. There would be about $60,000,000 additional revenue for each 1 percent increase in the corporate rate. I do not have the details with respect to the increases in the individual rate.

Senator Walsh. I do not think you understand my question. You want to raise $600,000,000.

Mr. Kent. Yes.

Senator Walsh. And you want to raise it by levying a certain percentage in the amount of tax being paid by corporations under the existing law; what would that percentage have to be on the average?

Mr. Kent. It would be between 25 and 30 percent, Senator. At the present time the estimates for 1936, under the present law, were about $1,100,000,000 from corporate taxes and about an equal amount from taxes on individual incomes. Now, to increase that by $600,000,000 would mean between 25 and 30 percent.

Senator Walsh. So you would have to announce to the taxpayers that their taxes would be increased 25 to 30 percent?

Mr. Kent. Yes.

Senator Black. Do you believe, Mr. Wilson, that profits derived by a person through his interest in a corporation's stock should be subject to any higher or lower rate of taxation than the profit derived from any other line of business?

Mr. Wilson. I am afraid I do not quite understand.

Senator Black. I will ask you in another way. An individual or partnership can make a profit on trading in various ways, or an individual can buy stock in a corporation and depend upon profit in the stock of the corporation. Do you believe it fair that the rate he pays on his profit on the corporation's stock should be the same as the rate he pays on the profit he receives from other lines of business endeavor?

Mr. Wilson. My offhand answer would be "yes."

Senator Black. If there is a system, whatever the system is, that makes some individual pay more on his profits derived from a corporation's stock than he does from other profits, and makes other individuals pay less on their profits derived from corporation's stock than is paid on profits derived from any other industry, that should be changed, should it not?

Mr. Wilson. I think so, without knowing all the conditions—

Mr. Black. The only condition I am speaking of is, a man may make a profit in several types of endeavor, trading as an individual, from a profession, from any line of business activity, including an investment in a corporation, or an investment in real estate as an individual. Now, as a matter of fairness, no system should be permitted to stand, should it, if it gives certain individuals an exceptional rate by reason of their investment in a corporation and a much higher rate on income from individual investment; that should not be allowed to continue?

Mr. Wilson. I do not think so.

Senator Black. It is wholly unjust and contrary to everything we believe equitable, is it not?

Mr. Wilson. I think so.

The Chairman. Thank you, Mr. Wilson. The next witness is Mr. F. C. Fulbright.

STATEMENT OF R. C. FULBRIGHT, REPRESENTING THE SOUTHERN PINE ASSOCIATION

The Chairman. You represent the Southern Pine Association, Mr. Fulbright?

Mr. Fulbright. Yes, sir.

The Chairman. Can you finish in 20 minutes?

Mr. Fulbright. I wish to go into some phases of the estimates here.

The Chairman. Try to get through as briefly as you can.

Mr. Fulbright. Before going into the presentation for the Southern Pine Association I want to take a minute to mention one other matter, and that refers to the amendment made in section 115 (c) at page 108 of the committee print, part I, of the bill before you. That section deals with distributions by corporations in liquidation. It has been very widely changed by the House upon recommendation of the Treasury Department so as to provide that where there
In complete liquidation of a corporation the amounts received will have the benefit of the provisions of the capital gains and losses, section 117-a. That has been the law previous to 1934, but in 1934 this section was changed so as to eliminate corporate liquidation from the capital gains and losses provision. Now, it was so left in 1934 that it constitutes a trap in some cases to unwary taxpayers to fall into it. In other words, if a corporation liquidated and distributed its properties to its stockholders, the stockholders did not get the benefit of section 117 with respect to capital gains, whereas if the corporation sold its stock to another corporation and that other corporation liquidated it to its stockholders, they got the benefit, and they could liquidate without any profit.

We have had some correspondence from people in the chairman's State and in Louisiana who got caught in that, and the only thing we ask is that the provision be made retroactive to December 31, 1934, where there are cases where companies were caught in that trap last year.

Senator King. Some have paid their taxes after having been caught in the trap.

Mr. Fulbright. It should be made retroactive to 1934, because it has been an unjust situation and is so recognized.

Senator King. If some have already paid we will no doubt have legitimate and equitable demands from those who have paid.

Mr. Fulbright. I think so.

I wish to state that the Southern Pine Association represents the softwood industry of the South; we have numerous small corporations, a few fair-sized corporations and we also have numerous partnerships in our industry. The Southern Pine Association has not had an opportunity to pass upon the provisions of this bill, but prior to its annual meeting on March 30 there was released from Washington the first report of the subcommittee of the Committee on Ways and Means—

Senator King. What percent of the lumber business of the South, the pine business of the South, is embraced in your organization, 10, 20, 30, 40, 50, 100?

Mr. Fulbright. I should say about 50 percent. There are numerous small mills and we cannot very well keep track of all of them; they move from place to place.

In that proposal there was also a proposal to tax distributions from reserves.

The CHAIRMAN. Just confine yourself to this bill, Mr. Fulbright.

Mr. Fulbright. The association considered the proposal which has been eliminated by the House. I shall not discuss it.

With regard to the general scheme of taxing undistributed net income, it was fully realized that while it would result in reducing taxes to them, they went on record as not approving the general principle involved in the bill.

Now, much of the comment that I make on this bill will not be matters which have been passed on by the association, but I have been or more, and I have listened with great interest to the presentations that have been made, and I wish to say at the outset that I do not believe there is any class of taxpayers today in this country that are demanding a tax reduction. Personally, I do not think this is the time for tax reductions. I believe we have necessarily had to undergo expenditures that make it necessary that we raise more revenue, and before I conclude I shall make some suggestions along that line, if I may.

But more I have studied the estimates that have been presented to the Ways and Means Committee and to this committee, the more I am convinced they will not raise the revenue it is thought will be produced.

I wish to make some observations for the benefit of this committee along those lines.

Now, of course, corporate returns do not show to whom dividends are paid; likewise, individual income-tax returns do not show the corporation from which dividends are received. It is a very difficult matter from the data available to make any complete study of the subject, as the representatives of the Treasury have told you; but even if they could get complete data, from what corporations they came and to what individuals they were paid, it would still not throw much light on the question as to what individual taxpayers will receive the dividends which will be forced out of the corporations by the new legislation. It is not correct to assume that the same persons who return as income dividends from corporations under the present tax system will be the recipients of the additional dividends, for the reason that in a large percentage of the cases the additional dividends will go to individuals who do not hold any substantial amount of stock in corporations now paying dividends.

Senator King. And under the present law will be exempt from the payment of taxes?

Mr. Fulbright. Yes, sir.

We can compute what revenue will be lost, but we can only speculate as to what will be obtained. The Treasury experts estimate $1,182,000,000. This is approximately 16 percent of the estimated corporate income for 1936 and is based upon the assumption that the entire corporate income will be distributed under the new law. Of course, this is not correct, because, as the Treasury points out, a substantial part of the income may be retained at a much less rate of tax than is now paid.

The CHAIRMAN. Do those figures include the 15-percent tax?

Mr. Fulbright. They estimate a total of 16 percent; that is, the 15 percent plus the guesswork taxes called excess-profits taxes.

However, assuming that all of the corporate net income will be distributed, we must also assume that practically all of it will pay 4 percent, which will leave a net loss of $844,000,000 to be compensated by surtaxes paid by individuals under the existing schedules.

In the case of corporations with small income it is admitted by the Commissioner of Internal Revenue that perhaps the majority of such corporations and a majority of the individual stockholders thereof will reap the benefit of a lower tax burden than they now sustain.

According to the statistics for 1936, the latest year available to the public, approximately 15 percent of the corporate net income returned is received by corporations having less than $50,000 net income. As
to these it may be said that there will generally be a substantial reduction in the combined revenue to be received from such corporations and their stockholders. In other words, none of the deficit will be made up from this class, but rather will the deficit of $8,444,000 be increased by the opportunities which are available to closely held corporations to very greatly reduce the total tax burden of the companies and their owners.

By far the most important group of corporations from the standpoint of tax revenue is the class returning a net income of $5,000,000 or more per year. In 1933 this class returned more than 30 percent of all corporate net income returned. This percentage, as well as that of the corporations having less than $50,000 income, is rather closely in line with the percentages for these classes as shown by statistics for former years. If this enormous loss is to be made up, it is obvious that we should expect that a considerable part of it should come from the class of corporations having taxable net income of $5,000,000 or more per year, particularly since they are by far the most important class.

An analysis of this class of corporations will disclose that the Government will not likely make up any part of the deficit from them and their stockholders. The reason for this is that most of the very large corporations have already built up reserves to conduct their business and follow the habitual policy of distributing nearly all of their net income from year to year. We have made an analysis of certain available data for the year 1933 and have used this because it is the latest year for which the revenue statistics are available. It will be noticed that in the presentation of the Commissioner before the House Ways and Means Committee actual figures were given only for 1931 and prior years. Round estimates were given for 1934 and subsequent years. In 1933, according to the report of the Bureau of Internal Revenue, there were 69 corporations returning a net income of $8,000,000 or over and the aggregate taxable net income returned by this class was $893,781,000, which constituted 9.29 percent of the taxable net income returned by all corporations.

Our analysis shows that instead of obtaining additional revenue from this class of corporations under the proposed bill there will be in fact an added deficit.

Senator King. If the 69 corporations whose net income exceeded $8,000,000 constituted only 30 percent—

Mr. Fulbright. Of the total income.

Senator King. And the total is 1,000,000,000 plus—

Mr. Fulbright. Yes.

Senator King. It would seem to me there was an hiatus there somewhere.

Mr. Fulbright. There are 49 corporations making returns of over $5,000,000. Their total return was $893,000,000. That constituted 30 percent of the total income returned by all classes of corporations. We have examined the annual returns of corporations as published with incomes above $5,000,000, and we selected 73 corporations. There were more than that number, but by combining them where we knew they would be consolidated we found there were 73. These corporations represent, perhaps, an approximation of the group on which the Bureau of Internal Revenue based its figures.

Senator King. That would be after their income tax was paid, their corporate tax.

Mr. Fulbright. Naturally, the distribution of the corporation would be, Senator.

This does not include some $20,000,000 of stock dividends.

Naturally, the income from these 73 corporations would be expected to be in excess of the taxable income figure reported by the Bureau of Internal Revenue. The range of net income, as shown in the annual statements for these corporations, was from approximately 5 to 197 million dollars, and in the aggregate total $1,118,000,000. In the year 1933, against this income, these corporations distributed $929,000,000 in dividends, or a percentage distribution of 83.56 percent of the total net income of the corporations.

Three corporations out of this list paid no dividends at all in 1933, although in the previous years of the depression they had continued to pay dividends even though their earnings, their earning statements, reflected deficits.

It is submitted that the figures for 1933 are not abnormal or out of line with any previous years from which such a comparison might be made for the reason that by 1933 many corporations had reduced their dividend rates from previous higher rates which had applied in 1930, 1931, and 1932.

Therefore, by taking the corporate distribution in dividend percentage of 83.56 percent and applying the schedules under the proposed Revenue Act of 1936, it can be seen that a taxable rate of slightly less than 6 percent would come into play. Five percent of $1,118,000,000 would return to the Government only $55,950,000 in taxes. Of course, under the new law it can be assumed that the distribution of $929,000,000 would be subject to added taxation in the form of the 4 percent normal tax. Therefore, $37,160,000 in additional revenue would arise from this source, or a grand total of $929,000,000 of revenue which would come to the Government from the 1936 Revenue Act in its effect on corporations of net income over $5,000,000.

The Chairman. Pardon me, Mr. Fulbright. I desire to announce that tomorrow morning we will start the hearing at 9:30; we have a great number of witnesses.

Mr. Fulbright. Mr. Chairman, I apologize for taking your time, but I think this goes to the very heart of what we are doing here. The question is: Are we going to get the revenue hoped for under this bill?

Now, we have verified these figures in other ways. We took all corporations from the manual, showing $10,000,000 or more of net income over the period of the last 5 years, and we went back for each of the years. In 1933 there were 56 of those corporations and they distributed 88.4 percent of their earnings.

In 1933 there was a less percentage; there were 51 corporations last year having earnings of more than $10,000,000, with a total net earn-
ings of $1,160,000,000, and they distributed $900,000,000, or something
over 75 percent.

Now, apply this bill to them and the average rate of tax would be
6½ percent. You would have a loss of approximately 5 or 6 percent
on all of that class of the large corporations by the application of
the bill. It would amount to many millions of dollars.

In 1934 the distributions of the similar class of corporations was
87½ percent. Back in 1931 and 1932 the corporations earning more
than $10,000,000 actually distributed more than they made. This
was for the reason that those corporations had built up reserves out of
which they could continue their dividend-paying policies.

I took a group of companies which I knew were outstanding com-
panies, selected more or less at random. I took the total income and
total dividends for 5 years. Those companies were the American
Telephone & Telegraph Co., American Tobacco, Consolidated Edison,
Corn Products, General Electric, General Motors, Pacific Gas, Public
Service of New Jersey, Procter & Gamble, Reynolds Tobacco, Stand-
ard Brands, Union Pacific. They had a total income for the 5-year
period of $2,532,000,000 and total dividend distributions of $2,637,000,000.
There was not one of them that did not distribute more
than 90 percent of its earnings for the period. I had
the International Harvester included in that, but I took it out because I found,
for the 5-year period, the International Harvester Co. had only earned
$15,500,000 and had paid out over $44,000,000 in dividends.
The International Harvester Co. kept its plant going and kept its men in
employment out of what it had built up prior to that time; but I left
it out of this calculation.

Senator KINO. You found many companies that paid out in di-
vidends more than their earnings?
Mr. Fulbright. Numerous companies. You will find they all are
companies with general stock ownership. On the other hand, we
know there are companies that do not do that; they come into the
small class. How are you going to make up this deficit?
It is my opinion that the estimate made by the Treasury that
there will be 4½ billion dollars corporate net income for the year
1936 which would not be distributed under existing law but which
would be distributed under the proposed law, is so highly specula-
tive as to be of little or no value. This estimate is arrived at by
estimating the total statutory corporate net income for 1936 will
be $7,200,000,000, or more than double the actual income of corpora-
estimate is about as good a guess as we can make at this time.

Personally, I am inclined to believe that it is about what is indi-
ated under the latest available business statistics.

The CHAIRMAN. I did not understand the Treasury said that
what we be distributed, but that is the amount of undistributed in-
come; they did not say it was distributed.
Mr. Fulbright. I gathered that, and I may be in error; I cannot
keep up with all of their figures, Senator. That is more than double
the amount of income of corporations that had income in 1933. I
am not criticizing that estimate, but from the analysis we have been
able to make of the reports up to date, there will certainly be a much
larger income this year than last year, unless something we do not
dream of now happens.

However, the assumption is made under existing law nearly $2,700,000,000 will be paid in net cash dividends, whereas in 1933 the
actual figures as to net cash dividends were $2,102,000,000. The net
cash dividends are arrived at by eliminating the dividends received
by corporations. It will be observed that while it is estimated that
the 1936 income will be considerably more than double that of 1934
on the other hand it is estimated that the net cash dividends paid will
only be about 25 percent more. In other words, while the net income
will jump from $2,086,000,000 to $7,200,000,000, the net cash divi-
dends would only be increased from $2,102,000,000 to $2,700,000,000.
The statistics of dividend payments by the large corporations, as
available from various statistical bureaus, indicate a much larger
proportion of income being paid out as dividends than revealed by
the estimate of the Commissioner.

Now, taking the $7,200,000,000, we estimate in this class of small
corporations, the less-than-$50,000,000 class, they have about 15 percent
of the income, or $1,080,000,000. There will be an 8-percent loss, a
$84,800,000 loss. Applying the 1933 base to those of $5,000,000 or
over, constituting 70 percent of the income, there will be a loss of
$129,000,000, or a total loss of $214,000,000 to add to the $84,800,000,
making $1,058,000,000 to be made up out of this intervening class.
We do not think it can be done.

Senator BLACK. You mean all of the corporations under the new
law, as you have computed it, the Government will draw a smaller
amount of tax from them and their stockholders by the new bill
than by the old law?
Mr. Fulbright. I think that will be conceded, Senator.
Senator BLACK. And their stockholders and they would have to
pay a much smaller amount of tax?
Mr. Fulbright. Much smaller.

Comparison statement of income-tax burden under present and proposed
revenue acts in case of corporations with small income

(By R. C. Fulbright)

For a convenient comparison showing the effect of the proposals in H.R.
12895 six illustrations are given, in each of which it is assumed that the
corporation has an adjusted net income of $20,000 and has three stockholders,
I. e., Smith, owning 50 percent of the stock; Jones, owning 30 percent; and
Brown, owning 20 percent. It is also assumed that the personal exemptions
and deductions to which each stockholder should be entitled are exactly off-
sert by salaries and other income.

In the first three illustrations (A, B, and C companies) the stockholders have
no other taxable income than the dividends received from the corporations;
whereas in the other three illustrations (X, Y, and Z companies) the stock-
holders have outside taxable income.

The A and X companies are situated so that they can afford to distribute
all of their earnings. The B and Y companies cannot afford to distribute more
than half of their earnings, while the C and Z companies can afford to distribute
70 percent of their earnings. The statements show the change in the tax bur-
den under the proposed law and the discrimination which will arise against the
less fortunate corporations.
I want to illustrate that by a table and data that has been passed up to the members of the committee. The first page is explanatory. We have taken A, B, C companies and X, Y, Z companies, and have assumed each has an income of $20,000, an adjusted net income, we will say, of $20,000. I wish to call your attention to the different assumptions. The first is that 100 percent of the income will be distributed; the second assumption is that 50 percent will be distributed; and the third is that 20 percent will be distributed.

Now, under the present law the A company, distributed 100 percent of its dividends, and we assume here that the three stockholders there, as the explanation shows, would have enough exemptions and deductions to take care of their outside income, their salaries, and so forth. Under the present law, that corporation would be taxed $2,640; only two of the individuals would pay any tax because they would not get into the surtax brackets—that is, the third individual would not pay any tax. Under the proposed law the corporation would pay no tax and the individuals would pay only $1,180.

You can see what the reduction is.

Now, then, the B company, we will say, has to improve its plant. Some of the lumber companies have said they need money to fix up the plant in order to manufacture a better quality of lumber than they are now able to produce, or it may be indebted in such a way it cannot follow the amortization plan that I would like to refer to if I had time. They have to retain 50 percent. You will notice that corporation and its stockholders are going to pay $3,940, or more than three times as much as the fortunate corporation that did not have to hold its money to build up its plant or do anything like that.

The third example illustrates that where a 30 percent reserve is made and 70 percent of the income is distributed, there is actually some saving, as has been attested by the representatives of the Treasury Department. But in that case I wish to call your attention to the fact that those corporations will be taxed very much more than the partnerships in business doing the same amount of business and having the same net income.

There has been a lot of talk here about partnerships, and I want to tell you about the partnerships. Business of a business of any size is not conducted by partnerships. We have the statistics on that. The Commissioner sent telegrams to all of the collectors in order that he might have here for this hearing the number of partnerships returns made last year. There were 205,492 of them; there were only 80 that had incomes of $500,000 or more. They used an illustration of a partnership of $500,000 income. Those partnerships were most likely professional partnerships; some of them may have been lawyers; it has been a great time for the lawyers, you know. Now, that is not all. Only 833 of the 205,000 had incomes of $100,000 or more, four-tenths of 1 percent of them. But when you take the little businesses, I tell you that this bill makes it a lot harder on the corporation than the partnership, and this exhibit proves it.

Senator Black. I thought you said it reduces the little business taxes.

Mr. Fulsright. It does, provided they can distribute the money. Look at page 2. In the case of the company that has to hold half of it, it shows an increase in taxes of 50 percent, and will tax it three times as much as if it were a partnership and three times as much as the more fortunate corporation which does not have to hold its money.

Now, on the third page, we have assumed that each of the stockholders had outside taxable income of $10,000, $6,000, and $4,000, respectively. Those are pretty good sizable amounts in my country, although they may be pretty small up here. They represent our best people, our business people down there. Where they distribute 100 percent of the income, the total taxes under the present law would be $8,320, and under the proposed law they would be reduced to $8,480. That may be nice, but those people are not demanding that taxes be
Now, there is another provision that was in the recommendation from the Treasury but which was changed on the floor of the House. They gave the corporation a 2½-month period after the close of the year to determine how much of the income it would distribute. In the House they crossed that out.

The CHAIRMAN. Do you not think that was a proper action?

Mr. FULBRIGHT. If they are going to get the money next year; but the trouble is that there are many companies that have not the remotest idea what their net income is until they take inventory at the end of the year, and then they are able to tell what they are going to do.

Senator King. According to the decline in their inventory for the solvency of their debtors.

Mr. FULBRIGHT. The gentleman who talked about hides showed that the price varied 2 or 3 cents he would be in a bad fix.

Senator Connally. In order to offset a decline in the value of inventories that occurs after the first of the year in determining his ability to pay taxes, the decline should be coincidental with the income?

Mr. FULBRIGHT. They would take the inventory at the beginning of the year and at the end of the year, and until the latter one is taken they have no way to tell what it is.

Senator Barkley. Do you not believe that any concern that is run pretty well knows what it has made in December of a year?

Mr. FULBRIGHT. In manufacturing lines, yes, sir; but in cotton, with which I am familiar, a cotton merchant does not know where he is until he gets his inventory.

Senator Barkley. We will take the year 1936. Now, he will take that inventory after the 1st of January. He has up to the middle of March to make out his income-tax report. Will he not have all of that inventory information before he is required to make out his income-tax report so as to offset his earnings?

Mr. FULBRIGHT. That is perfectly correct, but under the law now they would have to determine what their distribution would be before the close of the taxable year.

Senator Barkley. Not necessary.

Mr. FULBRIGHT. They would if they are going to get the benefit of the schedule in the bill. They cannot get the benefit of it otherwise.

I want to say this in conclusion—pardon me, Senator, did you have another question?

Senator Barkley. No.

Mr. FULBRIGHT. I want to make this suggestion, gentlemen: We had a tax bill passed in 1918 that produced more revenue than any special tax bill that was ever passed. We built up a body of regulations under it and a body of court decisions, and it was fair; that was the excess-profits tax. If a corporation made excess profits upon its capital, it paid a substantial additional tax. I do not think you will find a lot of business people howling for it, but it will produce revenue. If we are going to have this doubling up of income, $7,200,000,000 from these corporations, which the Treasury estimates, and I have no reason to believe the Treasury is not correct, I believe that we could by reenacting a tax on which we have the regulations, court decisions, and administrative methods all worked out, we could
get a very large amount of tax next year. I suggest that is an important thing for the actuaries to get busy on, rather than to launch into such a speculative thing. The Treasury says, "We are going to lose $1,132,000,000; now, where are we going to make it up?" They point out the different ways in which they can keep from paying income taxes, and believe me, they will be doing it. The lawyers and tax experts will show them how they can do it, and to the extent they can do it you are going to lack making up the $1,132,000,000, and unless you can get a more accurate statement than those which have been referred to, I do not think it is a good idea to embark on certain experiments.

Senator Black. Under this proposed legislation we are not likely to raise as much taxes as under existing law; is that your contention?

Mr. Fulbright. I think we will raise as much, but I do not think we will get any substantial increase.

Senator Black. How much do you think it would be?

Mr. Fulbright. I have not been able to complete my estimates, but those who pay 15 percent of the income, there will be a very large loss, and those who pay 30 percent, there will also be a large loss, and in the intervening class there will be a gain. How much it will be I have not been able to determine, as I have not completed my computations.

Senator Black. Have you examined what has been submitted by the experts?

Mr. Barkley. I have seen everything they have offered, both in the House and here. I can say I do not see where they are going to get any $600,000,000 in addition to the loss of the $1,132,000,000. They are going to lose $200,000,000 out of the A. T. & T.; they will go scot free; they will not pay any tax, and the General Motors will not pay any tax.

Senator Black. How about the people who draw the dividends?

Mr. Fulbright. Some members of my family have A. T. & T. stock, that is, my wife's kinfolks. Some of them have a very small income. It is not going to make a dime's difference to the Government as far as they are concerned.

Senator Black. How about those in the higher brackets; will it not raise them into a still higher bracket?

Mr. Fulbright. The A. T. & T. will pay just what they have been—

Senator Black. I am talking about the stockholders of the A. T. & T. who draw dividends and who may be in one income-tax bracket, and if they draw more, it puts them in another.

Mr. Fulbright. May I illustrate—

Senator Black. Does it, or not?

Mr. Fulbright. No, sir.

Senator Black. It does not affect them at all?

Mr. Fulbright. Not unless they have income from another corporation.

Senator Black. Suppose they have income from various corporations.

Mr. Fulbright. May I answer the question in my own way?

Senator Black. Yes.
Senator Black. Is it your view this bill works to the disadvantage of all of the corporations in this country which do not have big earnings?

Mr. Fulbright. I think ultimately that would be the effect, Senator. It does not necessarily do it to start with, because you have to take into consideration the position of the stockholders and whether it is closely held and whether they would take advantage of the loopholes.

Senator Black. One has a surplus and the other has to pay earnings.

Mr. Fulbright. But if one has only three stockholders and they can declare the dividends and put them back into the corporation as paid-in surplus, they would be on an equality, but if they have one stockholder who keeps it, or a guardian is appointed, as I have pointed out, they would have to have lawyers and it would not be as simple as you are led to believe.

Senator King. Have you any tables on the copartnership showing the number and how it affects them?

Mr. Fulbright. I did not have anything on that, except there were some figures put into the record before the House Ways and Means Committee, at page 428.

Senator King. Would you call two or three farmers who work together a copartnership?

Mr. Fulbright. Yes, sir.

Senator King. Has the Department so classified them?

Mr. Fulbright. It follows the common-law concept. If it is a joint-stock association it may be a partnership under State law, but subject to taxation as a corporation. Many of our lumber companies are copartnerships.

Senator King. I wondered whether they classified in the copartnership column a couple of shepherds who work together.

Mr. Fulbright. If they engaged in that business from year to year they are a copartnership; if they expect to dispose of the sheep the next year, it would be a joint venture.

Senator King. A couple of men who buy a grocery store and have $2,000 of stock, what is that?

Mr. Fulbright. A copartnership.

Senator King. Have you any figures showing the aggregate earnings of copartnerships measured by the gross earnings of all corporations?

Mr. Fulbright. We do not have the comparative figures. The figures I referred to are for 1933, and we do not have available the other statistics. Those copartnerships include engineering firms, law firms, and service firms.

Senator King. Not industrialists or manufacturers?

Mr. Fulbright. No, sir.

Mr. Chester. We can give you the estimated corporate income for 1935, and since the tax yield is running so close to the estimate, it would indicate the estimate on income is exact enough for your purposes, and it would give you a basis for comparison.

Senator King. I had in mind the gross earnings of partnerships and of all corporations.

Mr. Fulbright. I doubt if there are a score of partnerships engaged in business in this country where they will run over $100,000 a year. There are many law firms and things of that character where they will run in excess of that. I was rather astonished to note that only four-fifths of 1 percent of 200,000 partnerships ran into that.

The Chairman. I saw that reference you gave as to the earnings in the hearings on this bill in the House?

Mr. Fulbright. On this bill; it was in the report.

Senator Black. Suppose a stockholder in a corporation makes sufficient income so that he is in the 65 percent brackets for the year and the company declares a dividend, adding $10,000 to his income, what percentage of that $10,000 would go to the Government for taxes?

Mr. Fulbright. It would be in excess of 65 percent.

Senator Black. In excess of 65 percent?

Mr. Fulbright. Yes, sir.

Senator Black. If he was in the 45 percent brackets, it would be in excess of 45 percent.

Mr. Fulbright. Yes, sir.

Senator Black. And if he was a stockholder down in the 4 percent brackets, it would be somewhere in excess of 4 percent.

Mr. Fulbright. Yes, sir.

Senator Black. Now, if he is paying under the present corporation tax and that profit stays in the corporation, the corporation would pay 15 or 16 percent on profit, would it not?

Mr. Fulbright. Yes, sir.

Senator Black. Whether he would have to pay 4 percent or 65 percent or 72 percent; that is correct, is it not?

Mr. Fulbright. That is correct.

Senator Black. So that in the actual operation of the payment of tax on that profit it fluctuates from nothing up to 72 percent, so far as those dividends are concerned, as paid out to the taxpayer, dividends from the corporate profits.

Mr. Fulbright. Oh, yes.

Senator Black. Now, the individual earnings, the partnership earnings, do not fluctuate in that way?

Mr. Fulbright. No, sir. Whether they distribute it or not, they must return a certain proportion of the income of the enterprise.

Senator Black. So that in reality one of the issues here is whether or not the disadvantages you have described, so far as the corporation is concerned, outweigh an effort to prevent such a wide fluctuation in the amount of taxes paid on the profits which go from the corporation, as compared with the profits that the individual gets from other concerns?

Mr. Fulbright. I do not deny there are inequalities, but that is very rare, because business is generally run by corporations, and only small enterprises are run as partnerships.

Senator Black. Take yourself, as a lawyer.

Mr. Fulbright. I would get stuck with it.

Senator Black. You have to pay on the amount of the brackets in which you happen to have your earnings?

Mr. Fulbright. That is correct.

Senator Black. If someone else invests in a corporation, even though he may have a large income of several million dollars, which would place him in the higher brackets, on the profit made on the
Mr. Fulbright. But when he dies the Government will get theirs.

Senator Black. The Government may and it may not. If that stays there for 5 or 6 years and they declare a dividend, or suppose he sells it.

Mr. Fulbright. Then he pays profit on the increase in value.

Senator Black. A tax on the profit?

Mr. Fulbright. Yes, sir.

Senator Black. What percentage of profit?

Mr. Fulbright. If it comes in the capital net losses or gains, it would be in the schedule which runs from 1 year to 10 years, and scales from 30 to 90 percent.

Senator Black. And he formerly paid 12½ percent?

Mr. Fulbright. Yes, sir.

Senator Black. We changed that by the most recent law.

Mr. Fulbright. Yes, sir.

Senator Black. You have read where one man who everybody knew was very wealthy has paid no income tax at all, even though the corporations through which he did business, many of them, made profits; Mr. Morgan; if dividends had been declared on the stocks he had in various corporations, he would have had to pay an income tax, would he not?

Mr. Fulbright. Yes, sir.

Senator Black. And the probability is if the dividends had been declared these corporations would have had to pay far above what the normal man would have to pay?

Mr. Fulbright. Yes.

Senator Black. And to that extent it is an unfair operation of the present law?

Mr. Fulbright. I know there are inequalities and I do not know any formula that will get us away from all of them, but if you had the excess profits tax, Mr. Morgan would pay a lot more.

Senator Black. You know that every effort we make to enact any kind of tax law that reaches those gentlemen is difficult; there are numerous holes and they always find them.

Mr. Fulbright. I said before this committee when the 1934 act was up for discussion that a proper administration of a law like section 381—

Senator Black. What is that?

Mr. Fulbright. That is where they allow the gains to accumulate in a corporation beyond the needs of the business enterprise.

Senator Black. That is 382, is it not?

Mr. Fulbright. One hundred and two is the personal holding company, but 381 permits gains to accumulate where there is a presumption they are needed for investment in the corporation such as that.

Senator Black. It certainly is our duty to make an effort—we know we cannot have a perfect tax law, but we should see that no particular group is permitted to take advantage of any kind of device to pay smaller amounts of tax on their profits than others.

Mr. Fulbright. But here you do just the opposite.

Senator Black. I understand that is your construction.
Senator Black. I am talking only about the corporation as such. Is there anything sacred about a corporation?

Mr. Fulbright. No.

Senator Black. Is there any reason why a person making a profit out of a corporation, as such, should be subjected to a greater or smaller tax than on profits made in some other way than by a corporation?

Mr. Fulbright. I cannot answer that solely from the standpoint of Federal taxation.

Senator Black. Any standpoint.

Mr. Fulbright. If they are in the same enterprise the burdens should be the same so far as Federal tax is concerned, but in the State of Texas a partnership does not have to pay anything. You have to take all of those disabilities into consideration.

Senator Black. I mean a corporation, as such, and because of the fact it is a corporation.

Senator Kna. The following witnesses will be here at 9:30 tomorrow:


The committee will stand adjourned until 9:30 tomorrow.

(Whereupon, at 5:05 p. m., the committee adjourned until Saturday, May 2, 1936, at 9:30 a. m.)
SENATORS MOVE TO INCREASE TAX BILL YIELD $190,000,000 AFTER PLEA BY MORGENTHAU

SECRETARY URGES ACTION

Deficit for June 30 Put at the All Time High of $5,966,000,000.

INCLUDES ALL OF BONUS

Maximum Outlay Calculated for the Fiscal Year, Despite Nine-Year Amortization.

PROFITS TAX PLAN BACKED

Finance Committee Moves to Simplify House Rates and Corporation Classes.

By TURNER CATLEDGE
Special to The New York Times
WASHINGTON, April 30.—A movement to simplify the $809,000,000 Tax Bill, passed yesterday by the House, and to add about $160,000,000 to its annual yield for the next two years, took definite form in the Senate Finance Committee today following a plea by Secretary Morgenthau for enactment of the full revenue program outlined by President Roosevelt in his message of March 3.

Mr. Morgenthau insisted that the Tax Bill must be built up to the full yield originally asked in order to repair the damage done to the budget by the Supreme Court's invalidation of the Agricultural Adjustment Act and Congress's passage of the Bonus Payment Bill over the President's veto. These two measures, Mr. Morgenthau cited, have shot the prospective gross Federal deficit for the fiscal year ending June 30, 1936, to an all-time high of $5,966,000,000.

But for these two actions, neither of which was contemplated by the President in charting the nation's financial course last January, the budget would yet be on the basis of declining deficits, which, as the President has repeatedly said, would furnish an adequate guarantee for the strength of the government's credit. With these two items satisfactorily accounted for by the pending tax measure, Mr. Morgenthau estimated that the deficit for the fiscal year 1937 would drop to $2,875,700,000.

Needs $882,000,000 For Two Years

The Secretary of the Treasury charged the whole cost of paying the bonus, estimated at $2,337,000,000, to this year's expenditures, although the plan is to amortize the additional cost over a period of nine years at the rate of $130,000,000 per year. The deficit for the fiscal year will, of course, be decreased to the extent that the veterans refrain from cashing their certificates, but it is not figured that this will be a substantial amount.

It was to finance the extra bonus cost and the new farm program, the latter requiring $500,000,000 a year, and to make up the current deficit caused by invalidation of the Agricultural Adjustment Act and its processing taxes that the new revenue measure was required. As outlined today by Mr. Morgenthau, the need now is for a bill producing about $295,000,000 annually, for the first two years and $420,000,000 a year thereafter.

Mr. Morgenthau explained that the entire cost of the bonus had been added to this year's estimates of expenditures because the Treasury always anticipated the maximum in making its calculations.

"We estimate high on expenditures and low on revenues," he said.

Backs Profits-Tax Measure

Mr. Morgenthau repeated the President's recommendation that all of the new permanent revenue be provided by a new system of corporation taxes.

In line with this, the Treasury head praised the main provisions of the House measure—the new corporation tax based on undistributed incomes and the "windfall" levy to recoup at least $100,000,000 in formerly impounded or uncollected processing taxes—but said it fell short of $380,000,000 of the revenue necessary to place the budget in the position it occupied prior to invalidation by the Supreme Court of the Agricultural Adjustment Act and enactment of the Bonus Payment Bill.

Mr. Morgenthau suggested, as did the President in his message, that the old agricultural processing taxes be revived to supply the lam-Continued on Page Two
MOVE TO INCREASE YIELD OF TAX BILL

Continued From Page One

porary revenue. He did not, however, fully convince the Senate tax committee that this was the best method.

Harrison Studies New Proposals

Chairman Harrison said he was not yet certain whether the Finance Committee would consider reviving the closing-in taxes. Nevertheless, as he pledged himself and his Democratic colleagues to work for the full amount of the money asked by the President, indicating that if no other sources were found for the $100,000,000 additional annual funds, the processing taxes might have to be revived. He added that he was working to obtain another tax proposal which might supply the deficiency.

Secretary Morgenbesser especially emphasized the importance of reducing the corporate tax to the House which revises the present corporate tax structure by substituting a levy based solely upon undistributed profits. This, he said, would meet a situation by which, according to Treasury estimates, more than $5,000,000,000 of corporate income would be retrenched to surpluses during the present calendar year, with a resultant leak of $1,000,000,000 in Federal revenues.

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

Says All Will Be On Same Basis

Mr. Morgenbesser made no recommendations as to the rates or as to the technical form by which the undistributed corporate profits tax should be applied.

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

It was toward the complicated and controversial corporate tax, however, that the Senators were pressed to direct their efforts for simplification. An attempt will be made to do away with the complicated tables approved by the House and also the division of corporations into brackets, such as $10,000 a year or less, if more than $10,000, and so on, to arrive at a simple schedule of five or six brackets.

It would be the purpose, too, to levy the tax directly on the amounts of net income withheld by corporations from distribution to shareholders, rather than impose it in terms of the total net income. No classification of corporations would be set up for rat purposes, under the change which the Senators propose to make, but corporations of net income of less than a certain amount, say, $25,000 annually, might be given an outright exemption from the new tax of $1,000 or $2,000, which they might withhold as undistributed profits.

Simplification Plan Sought

The prime movers in the effort to simplify the bill include Senator Harrison, La Follette, Connolly and other administration followers. In preparation for future action, Senator Harrison asked Secretary Morgenbesser to submit a plan for simplification of the House measure, and especially for a shortening of the schedule of rates. He also urged that a plan be agreed on by both sides in connection with the idea of allowing a limited exemption to corporations of small incomes.

Senator La Follette asked that the scheme be worked out as applying directly to the amount of income withheld by corporations from stockholders as the total net corporate income as provided in the House bill.

Senate opposition to the new tax program was viewed today as continuing in decline. Senator Harrison gave evidence of that particular brand of confidence which he shows when positive that he is on the winning side.

"Why, with these few simplifica- tions which we hope to get into the bill, the Senate will pass it without question," said the Mississippian, "I never was more confident of anything in my life."

The case in which the measure was passed in the House went a long way toward melting prospective Senate criticism. The appearance today of Secretary Morgenbesser and his associates, Guy T. Helvering, Commissioner of Internal Revenue, and George C. Haas, Director of Research and Statistics of the Treasury, was credited with keeping the opposition on the defensive.

Mr. Helvering presented the same nature of argument which he previously had given to the House Ways and Means Committee. He suggested again that the main burden of the new corporate tax plan would fall on a limited number of corporations and individuals—71 per cent of the increase in taxable income would be received by individuals incomes of more than $25,000, and 46 per cent by those with incomes in excess of $100,000, and that the burden would come from new taxes but through stoppage of taxes to present lowess.

Mr. Haas took up senatorial questions which were asked during the Finance Committee's hearings.

Impressed by Morgenbesser

Secretary Morgenbesser's testimony had an obvious effect upon the Finance Committee's investigation, with which he testified and the quickness and definitiveness with which he answered questions practically excluded any cross-examination; so much so that Republican critics quickly abandoned their plan to subject him to partisan fire.

Only a few questions were asked of the Secretary. One was by Senator Harrison, who wanted to know if the $25,000,000 AAA floor tax revenue inserted in the bill by the House should be added to the deficit caused by invalidation of the AAA, estimated at $517,000,000.

Mr. Morgenbesser reached in a sheaf of papers before him and pulled out a sheet on which he had set down the deficit estimates for the present and next fiscal years.

"If it had not been for invalidation of the AAA and enactment of the bonus over the President's veto, the deficit for the present and next fiscal years would have been $43,000,000 instead of $517,000,000," the Secretary added.

"And we would not have had to pass a Tax Bill," put in Senator Harrison.

As to Estimates in Other Years

Senator Harrison asked if the record did not disclose that previous administrations had estimated their revenues too high.

"Again re-entering into his papers, Mr. Morgenbesser exhibited a document which set out the revenue estimates and actual collections over a period of six years.

"For 1931, the Treasury estimated revenues 15 per cent in excess of actual collections; 1932, 7 per cent in excess; in 1933, 13 per cent in excess, and 1934, 5 per cent in excess. For the fiscal year 1935, the first year's estimates for which he was responsible, Mr. Morgenbesser said, the tabled Treasury estimate exceeded the initial calculations by 4.8 per cent, and this year they were running about 2 per cent above."

The evidentiary preparation which the Secretary had made was such that the committee obviously discovered Republicans who were expected to question him on the few questions as indicated above, he was excused.

In his prepared statement Mr.
Morganthau made a special plea for enactment of a bill which would raise the full amount of revenue sought by the President.

"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," he said.

"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.

"I sincerely hope," he said in closing, "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 Jan. 5."
Prepared by Oliphant in answer to Sec'y's question that the tax bill that it will work to advantage of big corporations as against smaller ones.
It is argued against the proposed tax measure that it would
definitely hinder the growth of business enterprise and further monopoly
in that the small enterprise, which would otherwise have surplus with
which to expand its business, would lose that surplus and be unable to
expand its business because of distribution to stockholders. It is ar-
gued that in the past it has been by means of withholding distribution
and keeping earnings that small businesses have been enabled to grow into
larger ones. It is further contended that the proposed tax scheme would
so crystallize the present setup that the large corporations would con-
tinue to be large whereas the small corporations would be unable to grow.
This, it is claimed, is an evil.

In his statement to the Senate Finance Committee, Mr. Haas, on be-
half of the Treasury, pointed out that in fact under the bill the small
corporation is to be taxed much more lightly than the large one and that
adequate opportunity is offered, from a tax standpoint, for expansion.
There are also other answers to the contention.

Obviously the criticism proceeds from an assumption either that
the stockholders in the small enterprise will not re-invest a substantial
portion of the dividends received or that deduction of taxes will have
the effect of crippling the small corporation and prevent it from having
sufficient additional funds with which to expand. The latter assumption,
in essence, is based on the notion that the Government should give a
subsidy to small businesses which they may use with the possible effect of becoming larger corporations. If it is desired to have a tax program based on taxation of enterprises by size rather than by income then such a proposal could be considered, and if the philosophy were acceptable a much more equitable and more carefully thought out plan could be suggested. But that is not the present tax policy of this country.

It is more to the point to consider the former assumption, namely, that stockholders will not re-invest. In considering this question it is pertinent to ask why stockholders would not re-invest or why they should re-invest. One may assume that the stockholders who have received dividends have spent part in the satisfaction of their personal wants and that they have the remainder left for re-investment. The former expenditure will go, in the long run, to increased demand and hence in a larger sense to re-investment in industry. The question, in the last analysis, is therefore whether the individual stockholder will re-invest the remaining portion of his dividends in the corporation which yielded them to him or prefer to invest it in some other enterprise.

Stockholders with dividend incomes available for re-investment are divisible into at least two general classes. The first class would consist of those active in the enterprise. They may be the largest stockholders or they may be the dominating stockholders, or they may otherwise have the enterprise at heart. In their case there will certainly be no difficulty in re-investing. Indeed, the very assumption must be, from a
realistic point of view, that they and "the corporation" which is seeking to expand, and which needs its earnings to do so, are essentially identical. The difficulty, if any, is therefore limited to the situation of the second general class of stockholders, namely, the passive ones whose stockholding is in the nature of a more or less casual investment. These stockholders must be persuaded that the enterprise in which their original capital was invested is a sufficiently worthwhile one to justify re-investment. Realistically viewed these passive stockholders are always lenders of capital who have been drawn into entrusting their money to the majority or dominating stockholders by the expectation (if not the representation) that they would receive substantial dividends on their investment. In practice, they have been treated as persons having a claim against the insiders but a less enforcible one than, say, preferred stockholders or bondholders have.

Certainly the very payment of dividends to the passive investors would be a motivation to re-investment since the money could not be more judiciously invested than in the very enterprise which had proved itself to be profitable. On the other hand, if the passive investor prefers to place his money in some other enterprise it must be because he is not satisfied or he has not been persuaded that that is to his best interests to keep it in the same place.

The people who assert that they will be hampered in the expansion of their businesses, must, in the last analysis, be the majority or dominating stockholders who resent either the necessity to persuade the
minority that their capital investment is being properly handled or who wish simply to avoid the payment of taxes on the accretion to their own, personal, total wealth, represented by investment in the corporation, which is largely due not only to their own investment but to the investment of the passive stockholders who in many cases represent in fact a majority of the total invested capital.

Even if it be conceded, moreover, that there will be a certain amount of hindrance to expansion on the part of small enterprises that will not be compensated for by the increase in purchasing power and by the exemption of the enterprise from the burden of corporate taxation, the question still remains whether the disadvantage to the particular enterprise is not outweighed by the advantages to the greater masses of the population, that is, by larger public policy. Among these advantages may be listed the following:

1. At present the insiders use their power to withhold declaration of dividends for selfish ends. In many corporations we find that the decision of insiders to declare dividends is used for the purpose of selling long or short the stock owned by these insiders in their company. This is unfair to the remaining stockholders. A corporation which grows big by such devices is hardly a desirable one.

2. Often on the pretense that the accumulation is necessary to build up the financial condition of the company no dividends are declared. The effect is to depress the value of the stock to the passive stockholders.
while the insiders rely on other income in the form of salaries from the corporation or in the form of income from outside sources. When the stock has been sufficiently depressed the insiders buy up enough from the non-dominating investors to yield a large profit when they proceed, after they have published their intention to declare a dividend, to unload to new "suckers." This widespread corporate evil would be much less under the proposed legislation, for dividends would have to be more regular.

3. The tendency of insiders is to consider all other stockholders as nuisances who were brought into the enterprise because of the money they contributed but who were neither to have a voice in the management of the business nor to have any definite claim to a return on their investment. It seems a definitely valuable social result of the proposed tax bill that insiders will have to take pains, after they have induced the hitherto passive investors to place their money in the enterprise, to persuade them that the corporation is sufficiently well managed to deserve re-investment of profits. This will keep management on its toes and will go far to removing many evils of corporate management which have actually kept corporations from healthy expansion.

4. Since dividend receipts must necessarily be re-invested in some enterprise, even if they are not re-invested in the enterprise in which they were earned, there will in the long run be a spreading of investment which may turn out to be more advisable. This will tend to keep not only stock prices but industries themselves more stable.
It has been assumed in this discussion that surpluses have brought about the growth of competing units that prevent monopoly. In fact, however, it is very much to be doubted whether the larger enterprises have ever grown merely from re-investment. In the ordinary run of things enterprises do not grow so spectacularly. The average enterprise, if it is a profitable one, tends to be modest — otherwise we should have more and more breakdown in competition. The successful enterprise which grows into a Chrysler Corporation or a General Motors (even if not a Ford) is typically one which is either the result of integration with others or one in which outside capital is induced to invest after the business itself has demonstrated its possibilities. Underwriters and banking houses serve that function in the financial world. The additional capital which is necessary to make large businesses of the Chrysler type is obtained either through bond issues or through very large stock issues; typically it is not made merely through keeping surpluses in the business.

Furthermore, the surplus which is kept in the business is determined by what the people who dominate enterprises keep in after they have taken out enough for their own personal wants commensurate with the standard of living to which they think they are entitled. In such cases it is not the smaller investor who contributes to spectacular growth of enterprises.

It must be concluded that businesses which cannot induce re-investment of dividends available for re-investment are mainly businesses which
are managed or dominated by persons who wish to compel unwilling partners to continue in enterprises in which these partners do not believe. There is no social advantage in lending through the taxing power a further governmental hindrance to the unwilling partner's desire to get out of the partnership to the extent of the profits realized on the venture. It is enough that the courts and the laws compel him to keep invested the capital he originally threw into the enterprise.

Finally, it should be pointed out that there is nothing to indicate that the relatively small vigorously growing businesses do not now have reserves relatively as great as the giants of industry. How much reserves any corporation has is, in final analysis, merely a question as to the percentage of its solvency, and the mass of business, probably the relatively smaller units, are solvent at quite as high, if not a higher, percentage as the large ones.
MEMORANDUM TO SECRETARY MORGENTHAU

In Re: The Burden on Small and Large Corporations under the Tax Bill.

I have not had time, of course, to examine this question in any detail. It seems, however, that from one way of looking at it the large corporations will pay out less in taxes as corporations under the new bill than they did before, assuming that they make no change in the proportions of their earnings which they distribute annually. I learn that a study made over at the Federal Reserve Board shows that the large non-financial corporations reporting net income in the period 1923 to 1929 paid out in dividends some fifty-seven per cent of their net earnings after taxes. Under the House Bill they would pay fourteen and one-fourth per cent on their net earnings before taxes if they continued to pay out this proportion of their earnings in dividends.

Under the present Act they pay about sixteen per cent. This looks as if the new bill favors the large corporation. Actually, however, under the new bill there will be an inducement to the large corporation to distribute its earnings which does not exist under the present Act. As the purpose of the bill is not to increase the taxes on the corporations, but to increase the tax revenues to be derived from the income earned by corporations through the personal income tax, this is really irrelevant. The shareholders will exercise some pressure on the corporation to distribute its earnings, on the ground that otherwise the corporation would be subject to a tax from which it can escape through distribution of earnings. Under the present law, no such means of escape exists and therefore, under the present law there are no tax inducements to distribution of earnings, while there are important tax incentives to non-distribution.

It seems to me, therefore, that the proposed bill is to be appraised not in terms of the comparative tax burdens on a corporation under the old and under the new tax measures if that corporation adheres to its former practice with respect to distribution of earnings, but on the basis that the new measure puts pressure on the corporation to distribute its earnings by increasing the advantage to the shareholders, unless they are very wealthy, of such distribution.
MEMORANDUM TO SECRETARY MORGENTHAU

FROM: JACOB VINER

In Re: Negotiations with China

I take it that the Treasury objectives are:

1. A currency system in China satisfactory to herself.
2. As much absorption of silver by China for currency and other purposes as is consistent with (1) above.

The Treasury, as I understand it, is prepared to undertake the purchase of surplus Chinese silver at the market price, provided the purchases are spread fairly evenly over an extended period of time and provided the Treasury is left with discretion as to the precise timing of the purchases. I understand also that the Treasury is willing to undertake to give China a credit against silver deposited as collateral, against which credit China can draw when and if she needs dollar funds in greater volume than sales of silver at the scheduled rate would provide.

If these assumptions are correct, then it seems to me that the negotiations, as recorded in the file, are progressing favorably for both countries. The only comments I feel that I have to make are - first, that China should be advised to value her reserves at their actual market value, rather than at any artificial valuation. The fact that we follow a different practice should not be made the basis for urging similar foolishness on the part of other countries. Second, the Chinese apparently do not wish to peg to the dollar and we are obviously not anxious that they should peg to sterling. It seems to me that the best solution, which gives the Chinese the advantage of pegging and at the same time frees them from the charge by us that they have pegged to sterling or by the English that they have pegged to the dollar, would be for them to peg to a mean rate between dollar and sterling. Of course, this could work satisfactorily only with a certain margin of variation so as to avoid awkward fractions in the sterling and dollar exchanges, and would work very badly if the dollar and sterling should begin having marked variations relative to each other. But as long as the dollar and sterling are relatively stable in terms of each other, this seems to me to be the most satisfactory procedure for the Chinese.
May 4, 1936

At the 9:30 meeting this morning, the Secretary again inquired whether the tax bill would not be pretty severe on small and medium-sized corporations by preventing them from building up surpluses. Haas justified the provision in the pending bill by pointing out that corporations pay out dividends and offer to their stockholders "rights" to subscribe to stock and the stockholders in turn pay in their dividends and get more stock. HM, Jr. was of the opinion that stockholders in small corporations would not do that and cited instances of a few small concerns in Poughkeepsie where the stockholders receive their dividends and spend the proceeds but do not subscribe for rights.

HM, Jr. also inquired concerning the loop-holes in the bill which, if not plugged, would result in loss of revenue to the Treasury. The loop-holes are ways by which taxpayers and corporations can avoid paying the tax. Oliphant expressed complete confidence in McLeod's estimates. Upham, however, feels that McLeod's estimates are based on the supposition that the loop-holes have been plugged. HM, Jr. inquired of Mr. Upham who were the men on the Hill who had raised the question about loop-holes and Upham replied that Beaman, of the House Legislative Counsel, O'Brien, his assistant, and Mr. Kent of Internal Revenue are the fellows who have the information. Oliphant said he would get in touch with the three of them and talk it out.
Secretary Morgenthau

Mr. Herman Oliphant

After the morning meeting on the tax bill, worked on Harrison's suggestion of two slight changes to enable him to have the bill reported favorably.

With Upham and Kent, saw Beaman, Parker and other legislative experts at and after lunch to make a recheck on possible loopholes. I might say that our own experts on this are Messrs. Turney, Kent and Lusk, and possible loopholes have occupied most of their time since March first.

Turney and Kent confirmed my statement this morning that all major loopholes have been plugged, and there remain only those miscellaneous minor possibilities of avoidance, possibilities which we always have in the case of any general tax bill.

My recanvas of possible escapes with Beaman, Parker and O'Brien was not completed because of a special matter I shall mention below; although on general inquiry they referred only to Section 27(i) relating to intercorporate dividends which will have to be reworked because of the last minute amendment in the House making the dividend year the same as the taxable year.

Instead of Harrison's suggestion of a flat exemption of $2,000 for corporations with net incomes of less than $20,000, Parker suggested that we adopt one table (that with the higher rates), let corporations figure their tax under it, and then tax corporations with incomes of less
than $15,000 or $20,000 that fraction of the tax so calculated which their income is of $15,000 or $20,000. Much time was spent discussing this possibility of meeting Harrison's request for simplification, and it looks promising. George and I worked on it some this afternoon, and it looks as if it might be adopted without any loss of revenue.

I might add, generally, that having gone through this whole process in the preparation of the Revenue Act of 1934, and the Revenue Act of 1935, and knowing how our own staff and the two staffs on the Hill work, things are moving and are being handled in the usual way, and, as usual, the process of perfecting the bill will continue until final enactment.

Dr. Feis called me about a cablegram from Flack relative to the transfer of Brenner in Waite's office in Paris to Boston. I relayed the message to Gibbons as Feis requested.

/s/ HO
Mc
MEMORANDUM FOR THE SECRETARY:

Further conferences occurred this morning between representatives of the Canadian distillers and representatives of the Treasury Department and the Department of Justice, with the following results:

Consolidated Distillers

Mr. Forsythe, for Consolidated Distillers, made an offer to settle the Government's claim (amounting to $4,527,982.08) for the sum of $237,500, this to be liquidated in installments. To secure the payment of this amount, Mr. Forsythe offered to pledge with the Government certain stock owned by his company in a company known as Distilled Liquors Corporation. This stock is carried on the books of Consolidated Distillers at a value of $114,000, but has a nominal market value of $10 a share, or $237,500. Payment would be made according to Mr. Forsythe's proposal from time to time as the stock in question should be disposed of by Consolidated Distillers, the Government to assume the loss for any sales which might occur at a price lower than $10 per share. Additional payments would be made at the rate of 16 cents per gallon on all importations of the company's liquor into the United States until settlement had been made in full.

Mr. Forsythe was advised by the Government's conferees that his offer was unacceptable.

Mr. Forsythe stated that this was the final offer which could be made by his company. He stated, moreover, that he was not in a position to make any offer which would involve submitting his company to the jurisdiction of the United States courts and posting security to pay any judgment which the Government might obtain after litigation.

Mr. Forsythe was requested, and agreed, to submit the proposals which he had made in written form.

In the course of this morning's discussions, Mr. Forsythe stated that the controversy over the settlement of the Canadian distillery claims had now become an important political issue in Canada, and that he had no doubt that if the proposed legislation should be enacted it would result in breaking down the Canadian Trade Agreement. He went
on to say that the Prime Minister had already announced that in the event
the legislation were enacted, it would be necessary for Canada to have re-
course to the "escape clauses" of the Agreement.

Seagrams

Mr. Phillips, on behalf of Seagrams, who, as you have previously been
advised, had earlier made an offer of $500,000 in settlement of the Govern-
ment's claim, which offer was rejected, offered on alternative No. 2 to
furnish security for the payment of any judgment which the Government might
obtain against his company in the form of a surety bond for $750,000. He
qualified this by saying that he would be willing to increase the bond to
$1,000,000 provided the amount could be related to the current imports of
Seagram whiskey into the United States at a fixed rate per gallon.

Mr. Phillips was advised that his offer was unacceptable. In this con-
nection, his attention was called to the fact that Mr. Seth Richardson,
Washington attorney for his company, had advised the Senate Finance Com-
mittee that the company would be willing to post a cash bond in a larger
sum than Mr. Phillips' present offer. His attention was called also to the
fact that he himself at an earlier conference had suggested that his company
would probably be able and willing to furnish a surety bond in an amount
of, as he said, two or three million dollars. In other words, it was
pointed out to Mr. Phillips that his offer in the matter of security
made today was substantially less than previous offers which had been
made, at least tentatively, on behalf of his company.

Inasmuch as Mr. Phillips' offers, as he was told, were unacceptable
to the Government, and inasmuch as he had made it clear that these were
the final offers which would be made, he was advised that there would be
no purpose in further meetings, and that so far as the Government was con-
cerned the matter was regarded as concluded.

Mr. Phillips was requested to submit his offers in writing. He did
not agree to do so.

RECOMMENDATION

It is the opinion of the Government's conferees (1) that the nego-
tiations with the Seagram Company have definitely broken down; (2) that
Hiram Walker has no intention of undertaking to work out an agreement
with the Government; and (3) that unless substantial concessions are
made, no agreement is possible with Consolidated Distillers.

You will recall the following provision in the Department's memo-
randum of April 10, which was agreed to by the State Department:
"5. If negotiations with the companies carried on in accordance with the foregoing should be fruitless as to any one of the following companies, namely: Distillers Corporation—Seagrams, Hiram Walker—Gooderham and Worts, Consolidated Distillers, and United Distillers, the Treasury Department and the Department of Justice will be free to proceed with the legislation."

Inasmuch as the negotiations have proved to be fruitless with the Seagram Company, and without regard to the status of negotiations with the other companies, it is the opinion of the Government's conferees that the legislation pending before the Senate Finance Committee should be proceeded with at this time in accordance with the understanding had among the three Departments at the time the negotiations were begun; and that recommendation should be made accordingly to the Chairman of the Senate Finance Committee by the Secretary of the Treasury and the Attorney General.

GRAVES
May 1, 1936

HM,Jr. called the President and said he had talked to Cochran again and the interesting thing is that the British Stabilization Fund deals directly with the French banks; that the British will do all they can to keep the French from devaluing; that we bought another $500,000 worth of gold last night and that Cochran is going to see Schacht on Sunday -- he knows him personally and is going to see what he can find out.

At the group meeting asked the question whether the provision in the pending tax bill which places a tax on undistributed earnings is fair to the small business man. He said no one had convinced him that it was. He said, Ordinarily, big corporations are a handicap to the little fellow. Will this be an additional handicap to the small dealers? He turned to Haas and said, "If there are answers to this question, three cheers! But if there are not, let's be big enough and correct it. The pride of authorship is not the important thing if it is going to hurt small business." He added, "I have not had an answer to my question from anyone."
May 1, 1936

Dr. Viner came to Washington today from Chicago. The attached memorandum, in HM, Jr's handwriting, lists the things the Secretary wants Viner to do while he is here.
Jake Viner
Study china libre
Mexico silver

Chart showing price levels—
This manipulation of our price level in relation to
other countries
Any suggestions in case France-buy
values...
MEMORANDUM TO SECRETARY MORGENTHAU

In Re: Mexican Negotiations.

There are two points in the Mexican memorandum which call for attention.

First, on page 2, paragraph d, the Central Bank "would be authorized to acquire silver up to twenty-five per cent of its gold and foreign currency in stock, plus fifteen million pesos additional". This would make the twenty-five per cent ratio a maximum, with no obligation on the part of the Central Bank to hold any silver whatsoever as a reserve. What you would want presumably is that the twenty-five per cent should be a minimum.

Second, the memorandum ends on the theme that "the Government of Mexico looks forward to securing a price considerably higher than those prevailing today in the international markets". I see no reason why we should encourage them in this aspiration. Mexico is profiting sufficiently from the fact that we are providing a market for their silver at an artificially high price to make it altogether unreasonable on their part to ask us to pay still more. Aside from these two points, it seems to me that the Mexican arrangement is along satisfactory lines, leading to some absorption of silver by Mexico herself and reasonable cooperation with Mexico in establishing a currency system suitable to her needs.
May 4, 1936

Mr. Thomas L. McCarter, of New Jersey, saw the Secretary today. He said the holding companies would like to get rid of the subsidiary companies, but they are balked by the provision in the 1935 Tax Act. He would like to see that Act amended so as to reasonably eliminate the difficulties of taxation on mergers.

HM,Jr. suggested that he incorporate his views in a memorandum and send them to him personally, in care of Mrs. Klotz, and he would have our General Counsel study them.
My dear Mr. Secretary:

Yesterday I explained generally the situation of our Company. I stated that we were very desirous of simplifying our corporate structure. I pointed out that our sympathies all lay in the direction of simplification. I then stated that some method should be provided under which the simplification of corporate structures could be brought about without risk of unbearable and unknown tax liabilities.

Section 112(b)(6), which was added last year to the Revenue Act of 1934 by section 110 of the Revenue Act of 1935, was adopted by the Congress to facilitate simplification of corporate structures. In general principle, the section meets with my full approval. However, two technical difficulties are encountered in its application:

First, the section requires the ownership of 80 per centum of each class of stock. In our case this is quite impossible. We do own more than 80 per centum of all the voting stock of our principal subsidiary, but one class of preferred stock is in the hands of the public and has been for years. It would seem to me adequate if the parent company owned, for example, 80 per centum of all the voting power in the subsidiary. Certainly the result to the parent upon the merger of its subsidiary is identical. All the properties of the subsidiary will go to the parent. None will be distributed to the outside stockholders. Likewise, it would seem to me that the Government would be adequately protected, and certainly as well protected as under the present law.

Second, I am advised that, under the present law, the properties of the subsidiary when transferred to the parent would be given an entirely new basis upon which depreciation is to be computed. The law requires that the existing basis, which has been established only after many years of examinations and conferences with the Bureau, be abandoned; and that a new basis be prepared through a method of allocating to the properties some percentage of the cost to the parent of its stock in the subsidiary. Our accounting officers advise me that this allocation is not only most difficult and complex, but can not be made with any degree of certainty. It would seem to me that both simplification and
safety would require that depreciation of a subsidiary's properties continue on exactly the same basis after the liquidation as it did before.

With these two technicalities of the present law removed, I am confident that we will be in a position to bring about a most desirable simplification of our corporate structure, and I would assume that many other corporations are in a similar situation.

I have asked our General Counsel to prepare appropriate amendments to carry out the policies I have suggested. They are as follows:

Amend the first sentence of section 112(b)(6) to read as follows:

"No gain or loss shall be recognized by a corporation upon a statutory merger or consolidation with another corporation, if the corporation is the owner of voting stock (in such other corporation) possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote (whether or not such merger has the effect of a liquidation of such other corporation), or upon a complete liquidation of such other corporation."

Insert an appropriate provision in section 113(a)(6) so as to exclude therefrom a transaction described in section 112(b)(6).

Insert an appropriate provision in section 113(a)(7) so that this section will include a transaction described in section 112(b)(6).

I appreciated very much indeed the sympathetic consideration you gave to the problem I discussed.

Very truly yours,

(Signed) Thomas N. McCarter,
President.

Honorable Henry Morgenthau, Jr.,
Secretary of the Treasury,
Washington, D. C.
May 4, 1936

HM, Jr. was very much annoyed at Haas for not looking out for his men. McLeod broke down physically because of overwork and HM, Jr. felt that it was up to Haas to see that nothing like that happened in his Division. Mr. Morgenthau said that rather than have anything like that happen in the Treasury, he would rather ask Congress for an adjournment. He said that he personally looks after the heads of the various Divisions with whom he works closely and he expects the head of each Division to look after his subordinates.
HM, Jr. said the President called him at Fishkill in regard to appointing a man by the name of Truitt in place of Jackson. Truitt is Solicitor for the Reconstruction Finance Corporation. Oliphant told the Secretary he did not think well of this appointment at all and would send HM, Jr. a memorandum. (Copy of memorandum attached.)

(This applicant was endorsed by Jerome Frank in a letter, dated April 9, addressed to Mr. Edward Greenbaum and sent to the Secretary by Mr. Greenbaum. Copy attached.)
May 4, 1936

Secretary Morgenthau

Herman Oliphant

In re: Max O'Rell Truitt, Solicitor of Reconstruction Finance Corporation, for position of Assistant General Counsel for the Bureau of Internal Revenue.

Through Willcox and Harlan I have been able to get the following information about Truitt.

He is from St. Louis and is about 58 years old. Attended one of the local law schools and is married to Senator Barkley's daughter.

Snodgrass, who holds a high position in the legal staff of R. F. C. and who works very close to Truitt, makes the following confidential statement to Willcox about him: "When he thought of leaving, one of his former partners urged Jones to keep him in Washington 'for the good of the R. F. C. and the firm.' He is something of a busy-body, creating work for himself - conscientious, but not 'too wide between the eyes' - a pretty good trader - apt to start things he can't or doesn't finish. He has thrown several monkeywrenches, and the directors would vote a leather medal to anybody that took him away from the R. F. C."

Jim Alley, General Counsel of R. F. C., told Harlan confidentially that he is a very mediocre type of lawyer; the position he holds is one which was created to take care of him, and, he will be very glad to have us take him off his hands.

(Signed) Herman Oliphant

JGH-hbk
Washington, D. C.
1016 Interior Building.
April 9th, 1936

Mr. Edward Greenbaum,
C/o Greenbaum, Wolff and Ernst,
265 Madison Avenue,
New York, New York.

Dear Eddie:

PERSONAL AND CONFIDENTIAL

The suggestion has been made in certain quarters that Max Truitt be named as successor to Bob Jackson as General Counsel for the Bureau. Max is now Solicitor (not General Counsel) for RFC. Confidentially, his life over there has not been an altogether pleasant one, because he has refused to be a rubber stamp for the Chairman; I am making this statement because his relations to the Chairman might be a matter of interest to the Secretary.

I have worked with Max on many matters, and particularly in connection with the Missouri-Pacific - Van Sweringen matters. He is an excellent lawyer, and has admirable common sense and poise. I have seen him handling his administrative activities, and there he functions beautifully; he knows how to guide and counsel his numerous assistants, and how to keep the work moving. His integrity is beyond question. He happens to be the son-in-law of Senator Barkley of Kentucky. He is a good friend of, and highly regarded by, Stanley Reed. I think he would be an ideal man for the job.

Yours sincerely,

(Signed) Jerome
Jerome N. Frank.

P.S. He is a liberal conservative.
May 4, 1936

HM, Jr. told Gaston and Mrs. Klotz this afternoon that over the week-end the thought came to him that he might like to go on the air on the night of Sunday, June 14, and say something like this: This is the night of June 14. Fifty weeks out of the 52 weeks of this fiscal year have passed. Let us take a look at the deficit as it is tonight. What did the President say it would be? Going today on the assumption that the deficit at the end of 50 weeks of this fiscal year will be less than it was the previous fiscal year (and at the same time I want to say that tomorrow we add to the books of the Treasury $2,300,000,000 for the bonus) that up to tonight the President has lived strictly within his budget message and has done what he said he would do.

The Secretary met Mr. Paley, of the National Broadcasting Company, and Mr. Paley told him that it was about time he made another radio speech and HM, Jr. took occasion at that moment to tell him about the thought he had that he might want to go on the air on June 14th. Mr. Paley said that Jim Farley was scheduled for June 14 to speak on the bonus, but that they would put him aside if the Secretary really wanted to talk.

HM, Jr. checked this with Steve Early, who said he thought it was all right, but that HM, Jr. ought to be sponsored by someone rather than have it look as though he was asking for the chance to talk. HM, Jr. told Steve Early that he was not running for office and there was nothing that he really wanted, but that if he did talk at all he would do so feeling that it was good for the President.

The Secretary asked Gaston to see the three broadcasting stations and try to arrange an hour for him. He said he does not want to give it to any one company alone.
May 4, 1936.

My dear Mr. Bell:

Mr. Hackworth and Mr. Pasvolsky have told me of the extremely interesting conference which they had the other day with you and your associates. I am glad that it was possible to arrange this useful exchange of views.

In accordance with your request, I enclose here-with a brief memorandum on the "Policy Aspects of Proposed Treasury Action Under Section 303." While the statement is necessarily somewhat rough, it contains what we believe to be the essential considerations involved.

Sincerely yours,

[Signature]

Assistant Secretary

Enclosure: Memorandum.

The Honorable
Golden W. Bell,
Assistant Solicitor General,
Department of Justice.
Department of State

Bureau Division | TA

ENCLOSURE

To

Letter drafted: 5-2

Addressed to

The Honorable
Golden W. Bell

Regraded Unclassified
1. The German practices against which the Treasury contemplates the imposition of countervailing duties arise out of the foreign exchange control operating in that country. They should, therefore, be appropriately regarded as currency measures, constituting special forms of currency depreciation. This nature of the practices in question is entirely clear in the case of blocked marks, ASKI marks, and barter transactions. The scrip procedure, although somewhat more complicated, is of the same general character. The bond procedure is more of a borderline case and may conceivably fall outside the sphere of purely currency measures.

2. Currency manipulation of the general type used in Germany is employed by a number of other European countries and by several countries in South America. If it is decided to invoke Section 303 against Germany, it is difficult to see how the Treasury can fail to invoke the provisions of that Section against the other countries employing the same practices.
3. The invocation of penalties against currency procedures which involve partial depreciation is bound to cause ill-feeling and is likely to lead to retaliation, especially in view of the fact that no punitive action was taken by foreign countries concerned against the depreciation of the dollar and the other currency measures adopted by us.

4. Treasury action under Section 303 against such South American countries as Argentina, Brazil, Chile, and Uruguay, which employ multiple currency systems essentially similar to that of Germany and against which countervailing action would logically become unavoidable once it is taken against Germany, would be particularly unfortunate in view of the approaching conference at Buenos Aires.

5. In addition to the ill-feeling that it would generate, countervailing action against currency measures would result in substantial injury to our export trade. There appears to be no doubt that Germany is experiencing at the present time genuine difficulties in procuring dollar exchange with which to pay for her imports from the United States. Her purchases from the United States, particularly of agricultural products and certain raw materials such as cotton, fruit, tobacco, lard, lumber, petroleum, and copper, have already been greatly reduced. Such
Such trade as still exists has been made possible mainly by the employment by the German Government of special currency arrangements. The imposition of countervailing duties on a long list of German goods because of such arrangements would, of course, reduce our purchases of German goods and thus lead to a still further loss in our sales to Germany. The same considerations apply to the other European countries employing currency manipulation and to the South American countries named above.

6. There is no evidence that imports from countries with multiple currencies are marketed in the United States on such terms as to compete unfairly with similar domestic products. The currency procedures employed appear to be designed primarily to overcome the price and foreign exchange maladjustments resulting from the depreciation of some currencies, including the dollar, and failure on the part of the countries employing multiple currencies to effect a complete depreciation of their currency units.

7. It appears clear that the imposition of countervailing duties against Germany is not necessary as a safeguard for our producers, but would cause a definite injury to our exporters. Moreover, such action would result in the creation of new barriers to trade and would, therefore, run directly counter to the purpose of our trade
trade agreements program, which is designed to bring about a reopening of foreign markets for our burdensome surpluses through a reduction of trade barriers.
Monday
May 4, 1936

HMjr: Cochran?
H. M. Cochran: Yes

HMjr: Good morning
C: Good morning, sir

HMjr: Did you go away over the weekend?
C: No, because my friend was still in Berlin.

HMjr: I see.
C: And I would have had to gone there for Saturday morning.

HMjr: Yes
C: And we had conferences with the leader that morning.

HMjr: I see.
C: And - the leader from that little place -

HMjr: Yes
C: Now -

HMjr: Now, Cochran -
C: I'd better wait here now and see him when I go to Basel this week-end.

HMjr: That's all right.
C: Yes

HMjr: Now, Cochran -
C: He has the right dope on that situation.

HMjr: Do you mean on the election?
C: No, I mean on - on our neighboring country and on the Doctor.

HMjr: How do you mean?
C: That the appointment of the big fellow, you know, the military man - ?

HMjr: Yes
C: is in accord with the Doctor's wishes.

HMjr: Does what?

C: It's in accordance with the Doctor's wishes.

HMjr: Oh, it is?

C: It strengthens his position for the present.

HMjr: What is that?

C: And I say it really strengthens the Doctor's position at present.

HMjr: Just a minute - I see.

C: And I don't think anything there is likely to happen now.

HMjr: Well, we'll wait until you - over the week-end - next week-end.

C: I'll be going down to Basel probably Friday night.

HMjr: All right, now -

C: It's still quiet down here -

HMjr: Yes

C: Thursday night

HMjr: O. K.

C: Otherwise not until Friday night.

HMjr: Now, Cochran -

C: Yes

HMjr: We're getting an awful lot of gold today.

C: Yes, I know -

HMjr: And --

C: - a telegram at one o'clock.

HMjr: Yes, well what was the - what's the situation right now?
C: Well, I just talked to the Guaranty man who loaned us some nine billion dollars.

HMjr: Yes

C: At half past twelve the National City had done twelve million over five million - the National City.

HMjr: Yes

C: And some other people working - and I talked to our particular friend, you know, at the bank, Cariguel?

HMjr: Yes

C: He told me that private banks were taking care all right of the demand for dollars.

HMjr: Yes

C: They raised the quota of this bank so the turn-over is tremendous.

HMjr: Now, of course you know the English have let sterling run up?

C: Yes, it's - the paper down there, you see?

HMjr: Yes

C: Many of our people could not liquidate theirs.

HMjr: Are they very nervous?

C: They're a little nervous here, yes.

HMjr: Well, now -

C: There are rumors on the market that the Governor and some of the more conservative regents of the bank may resign.

HMjr: Yes

C: And then there are various rumors that the present Government likes this situation for a day or two and if that will continue this Government will give out a statement on the gold embargo.

HMjr: When does the Cabinet meet, Wednesday?

C: Tomorrow -

HMjr: Tuesday?
C: Yes, Tuesday -

HMjr: Well, they meet - the Cabinet meets Tuesday? - Hello?

C: Yes - yes

HMjr: Do you think that they'll stay on until June 1?

C: It's absolutely difficult to say. This man wants to stay on -

HMjr: Yes

C: Just a little more now and then he would stay on and if any drastic action must be taken, he wants to take it -

HMjr: Yes

C: Rather than sympathize and let Reynaud do it.

HMjr: Yes

C: I mean that's the way it looks today so far.

HMjr: I see.

C: Still too early to say, but -

HMjr: Well, now -

C: I this all myself and I sent you one wire and I'll send you another one this evening.

HMjr: Well, now Cochran -

C: Yes, sir

HMjr: If anything very important happens use the telephone.

C: All right.

HMjr: If something very important.

C: Well, surely if I ever get any word about embargo -

HMjr: Yes

C: Or a resignation of this Government -

HMjr: Yes

C: I'll see that you get it.
HMjr: Yes, use the telephone because the Cable service is too slow.

C: Surely - well, this morning I just summarized the election and the gold movements up until one o'clock.

HMjr: Yes

C: And so I'll get in touch with the other people this afternoon.

HMjr: O.K. - Thank you - goodbye.

C: Goodbye.
May 4, 1936

Dr. Tugwell and his assistant, Mr. Baldwin, and Mr. Bell met with the Secretary today.

The following is stenographic report of the meeting:

HM, Jr.: Before we get down to actual figures, let me just tell you what's going through my head. Either today, or tomorrow or the next day, Dan and I are going to have a pistol put to our head — at least I think so — by the President and by Hopkins, because I don't think Hopkins has enough money. I want to tell you everything I have in my mind. I think that is always the best way. That's one problem. And Dan and I have to make up our minds whether this idea of setting up projects, setting up money ....

Dr. Tugwell: That's worried us, because already we are 20 or 30 millions off on that.

Mr. Bell: You mean in the hole?

Dr. Tugwell: Sure! You know that. And that's serious.

HM, Jr.: Whether we are going to do it or not, I don't know. Whether we are going to be ordered to do it, is something else.

Up to now, the President has thought that when you start something you ought to have enough money there to finish it. The pressure is getting more and more each day. How much is Hopkins up against it?

Mr. Bell: Within the next week he's going to be up against it in certain sections.

HM, Jr.: It will take me a little while to get around to the point.

The question I want to ask is this: I haven't got an exact figure, but I think it is something like 40 or 50 millions to buy land, from various appropriations.

Mr. Baldwin: About $48,000,000.

HM, Jr.: Of which I understand you claim it is all obligated?

Dr. Tugwell: Yes; all obligated.
HM.Jr.: I also heard what the President said about complaints. I don't make any investigation of anybody. You know that.

Dr. Tugwell: I don't care whether you do, Henry.

HM.Jr.: I have had no investigations made. There are a lot of things which I don't know, if I seem to go around backwards. Why shouldn't Soil Conservation purchase the land -- why shouldn't that whole thing be under Soil Conservation in the Department of Agriculture?

Dr. Tugwell: Well, I don't know. Maybe it should.

HM.Jr.: The $500,000,000 that they have for Soil Conservation and all the Soil Conservation work they are doing -- why that should not be in there? I am thinking of the Department of Agriculture.

Dr. Tugwell: We want this thing moved up to the Department of Agriculture and there is a bill up there to that effect -- that's the Farm Tenant Act.

HM.Jr.: Any chance of that passing?

Dr. Tugwell: I don't know.

Mr. Bell: There really isn't any chance?

Dr. Tugwell: I don't think so. Of course, you understand that while Soil Conservation Service does all of its work on private lands, it does not do any on public lands. And you understand that Soil Conservation of AAA just pays benefits for planning better soil for crops, but this takes land out and puts it into the public land.

HM.Jr.: Perfectly frankly, I feel this very strongly and I haven't gotten anywhere on it up to now, that to take what I said is money which was supposed to be for relief purposes and buy land, it has never gotten down so dramatically that it is a question now of whether we should take care of people on relief or whether we should buy land.

Dr. Tugwell: I supposed that question was answered a year ago when the President told us to do this. You understand, it has been going on for a long time -- since the spring of 1933.
EM,Jr.: Where did it start?

Dr. Tugwell: It started in Interior, moved to Hopkins and transferred to us. I think if you saw the operations of the thing, you would realize that it is one of the best. You understood, we pay less than $4.00 an acre for this land. That's the average. There is some high-priced that was given for recreation purposes, but, you see, people were taken off these lands and resettled.

EM,Jr.: Where are they resettled? How much of that actually happened? How many families?

Dr. Tugwell: I could not tell you, because we do most of it by loan. We give them a Rehabilitation loan. We buy land and if they have an equity, they resettle themselves, but if they don't, we give Rehabilitation loan to settle them somewhere else or go through the Resettlement phase, which is a much longer process. About 15,000 families.

EM,Jr.: Unfortunately, when I had the time to be interested exclusively in agriculture, I have never seen it successfully done. That does not mean it can't be done.

Dr. Tugwell: I think that's right.

EM,Jr.: But I have yet to see -- whether you take families off the hill tops and try to move them somewhere else -- it wasn't done successfully in New York State anyway. The President moved 1,000 families out of Syracuse .....

Dr. Tugwell: I think that's another kind of thing.

EM,Jr.: But unfortunately I have never seen it done.

Dr. Tugwell: We have a couple of hundred thousand cases where it has been done successfully, in this sense. They have begun to repay back their loan and have supported their families on the place.

EM,Jr.: I thought you said 15,000 families.

Dr. Tugwell: You have to distinguish between Rehabilitation loans and actual Resettlement where we buy the land and resell it to them.
HM, Jr.: You have $48,000,000 to buy land and I take it that is all for Submarginal land?

Dr. Tugwell: That is right. Yes.

HM, Jr.: Then you have other money with which to buy good land?

Dr. Tugwell: Yes.

HM, Jr.: How much?

Dr. Tugwell: I don't know; that comes in as part of the project.

Mr. Baldwin: We have already, or will buy about 15 or 16 million dollars.

Mr. Ball: Is that in your Rehabilitation program?

Mr. Baldwin: That comes out of the $91,000,000.

HM, Jr.: But the $48,000,000 is exclusively for buying Submarginal land?

Mr. Baldwin: Yes. The program was originally a $114,000,000 program. We actually had $78,000,000 at one time and now we are down to $48,000,000.

HM, Jr.: And now I am trying to take some of that?

Dr. Tugwell: True, I don't think you can because options are already accepted.

HM, Jr.: But you don't mind my challenging that in a courteous manner?

Dr. Tugwell: No.

HM, Jr.: I don't understand it but I would like a lawyer to do it for me. But I can't get it through my head. We asked for 4 billion 8. The President intimated that about half of it would be returned to the Treasury and if we get 5% back we are lucky.

Dr. Tugwell: You understand, most of that did not come out of the 4 billion 8.
Mr. Baldwin: The $48,000,000, you mean?

HM, Jr.: But I can't get this thing through my head. It is not for Parks.

Mr. Baldwin: Parks, Grazing Areas, Reclamation Areas. We have 60 thousand men working now and as soon as we get it developed we will turn it over to the proper officials.

HM, Jr.: You have the CCC camps?

Dr. Tuwell: Some.

HM, Jr.: But these are not lands that are being bought for the CCC. That is another land program.

Mr. Bell: This is a part of it and the Forest Service has some.

HM, Jr.: How much have they?

Dr. Tuwell: 12 million.

HM, Jr.: Henry Wallace tells me he has not yet been able to get a statement from Ickes on how much land will be put in production.

Dr. Tuwell: We arrived at a figure that was satisfactory to the President last year.

HM, Jr.: As I say, I know I am up against an almost impossible situation but I am going through and above board and make an effort. Nobody can say I am going behind his back.

Dr. Tuwell: I think this is the most fundamental relief that you can get.

HM, Jr.: If somebody some day would take these thousand pieces in this Relief program and make them headed and knew where we were going, it would be lovely.

Dr. Tuwell: I think it has worked out pretty well.

HM, Jr.: I am sorry - I disagree with you. You mean the whole relief thing?

Dr. Tuwell: Yes.
HM, Jr.: We have two million people on direct relief. The cost of direct relief is constantly mounting and you have at least one million people who want work and can't get work. It is all a part of relief.

Dr. Tugwell: It is not a part of the problem of administrative relief.

HM, Jr.: We are going round and round and round and there are more people on direct relief today than there were a year ago.

Dr. Tugwell: I think that we are the only people that have made any contribution to take people off relief.

HM, Jr.: My struggle is pretty big — I expect too big — but I would love to argue with you and Harry some evening.

Dr. Tugwell: I think we have 150 thousand families who would have been on relief who are not now.

HM, Jr.: Let me come back to the 24 - 48 hour basis; The other thing I would like to do just as soon as Harry has a night and you have a night.

Dr. Tugwell: Any one who has looked into the Rehabilitation thing says it is the only program that is really good.

HM, Jr.: You have $48,000,000 to take this land out of production and the Forest Service has, how much?

Mr. Bell: 12 million. They had $12,952,000 for their whole program. This is out of the 4 billion 8 and they had $20,000,000 obligated and they have spent $11,000,000.

HM, Jr.: How much altogether would they get?

Mr. Bell: Approximately $25,000,000 for their whole thing and $12,000,000 was for land. They say they have obligated $20,000,000.

HM, Jr.: What was the rest spent for?

Mr. Bell: Administrative expenses, cleaning it up and so forth.

HM, Jr.: How much more for land?
Dr. Tugwell: That is all; except the Biological Survey got some but that was by statute.

HM, Jr.: $60,000,000 for land out of production?

Dr. Tugwell: That is right.

HM, Jr.: How much to buy good land?

Mr. Baldwin: That is mixed up in our other funds; all mixed up in the projects. It will run from 12 to 16 million dollars.

Dr. Tugwell: I don't think its accurate to separate it from projects. You can't do a Resettlement job without land.

HM, Jr.: True, but how much would Ickes have to buy? Can you figure how much he is spending for land?

Mr. Bell: I don't think he is buying any land.

Dr. Tugwell: Of course he is.

Mr. Bell: You mean in Reclamation?

Dr. Tugwell: School houses have to have land. It all comes out of relief funds.

Mr. Bell: He loans 50% of the cost to the School houses and that is part of the land and part of the project.

Dr. Tugwell: Just the same as we do? He buys land the same as we do?

HM, Jr.: Let us say $60,000,000 is spent to take land out. How much good farm land will Ickes bring in through building dams and all that sort of stuff.

Mr. Baldwin: That is going to be spread over a period of years.

Dr. Tugwell: I think we figure, over a period of two years, it would be 150 thousand acres. We have not been able to get figures.

HM, Jr.: But the figures on how many the various Reclamation projects will bring in?

Mr. Bell: Did not the Secretary of Agriculture say something at Emergency Council Meeting - and the President said he wanted it confined to 500,000 acres in the Reclamation Service.
Dr. Tugwell: What we arrived at was: He gave us $100,000,000 for Reclamation projects and gave us $20,000,000 for buying land and the other $25,000,000 comes of the 3 billion 3.

HM.Jr.: Have you a regular form of contract that you use in buying this land?

Dr. Tugwell: Sure.

HM.Jr.: Could I see that?

Dr. Tugwell: Sure.

HM.Jr.: Maybe I could send somebody over to your shop?

Dr. Tugwell: He could see Dr. Gray or Monroe Oppenheimer.

HM.Jr.: And the other thing, you have over 500 thousand families that you have taken care of.

Dr. Tugwell: Over 500,000.

HM.Jr.: What is going to happen to these families after July 1st?

Dr. Tugwell: I have no more idea than you.

HM.Jr.: Dan, this is right well prepared. Under Rehabilitation loans to clients we run out of money in December.

Mr. Baldwin: Yes, all our money will be obligated on the first of July but a list of those payments are scheduled to go out.

Dr. Tugwell: We make a farm plan which is spaced over a year for farmers' meetings, which is supposed to rehabilitate them.

HM.Jr.: Then this money comes back? To what approximation?

Mr. Baldwin: About 70%.

HM.Jr.: And you have how much for Rehabilitation?

Mr. Baldwin: About 100 million.

HM.Jr.: Would you expect 70% of that to come back?

Mr. Baldwin: Yes, it comes of the miscellaneous receipts.

HM.Jr.: So we can't spend it again?
Mr. Bell: No, we can't spend it again.

HM Jr.: Then out of the 275 million?

Dr. Tugwell: On our Resettlement project you will get 100% back. We sell the farms.

Mr. Bell: That is 22 million and you will not get any of the land retirement money back?

Dr. Tugwell: I had figured it. I could give it to you roughly. About another 70 million.

Mr. Bell: That would be 140 million, all told?

Dr. Tugwell: Yes, 140 million. You are going to get interest on all that comes back.

HM Jr.: Is that fairly conservative?

Dr. Tugwell: Fairly conservative.

HM Jr.: All long-term?

Dr. Tugwell: Some over 40 years.

HM Jr.: Could you give me a memorandum on estimated repayments by kinds of projects?

Dr. Tugwell: Glad to.

HM Jr.: Certain types of work where certain money is allotted and you expect so much back over a period of years? How much each year and do it by kinds of work?

Dr. Tugwell: All right.

HM Jr.: I did not know it would be that much.

Dr. Tugwell: Our past experience leads us to believe we will get back 78%. We will get more in some States and in Georgia we have collected 80% already.

HM Jr.: Myers averages about 70%.

Dr. Tugwell: Our loans are made very carefully.

Mr. Bell: Myers figures about 66 to 70% over a term of years. Last year it was only up to 56% but this year he will collect some.
Dr. Tugwell: Rehabilitation loans are two and five year loans — five years for capital goods and two years non-capital.

HM, Jr.: Are you still taking on new families?

Dr. Tugwell: Yes.

HM, Jr.: Have you set yourself a limit?

Mr. Baldwin: About 625 thousand families.

HM, Jr.: Is that the maximum you have set?

Dr. Tugwell: The maximum for our funds but you add that to our grants then we will be up to around 700 thousand families.

Mr. Baldwin: The total families we are looking after will be in excess of 700 thousand.

HM, Jr.: You buy this and that and the other thing and then you give them some land?

Dr. Tugwell: Not ordinarily.

HM, Jr.: Do you have different types of plans in different parts of the country?

Dr. Tugwell: Yes, but they are all on one farm. The County Committee figures what this man needs to be rehabilitated.

HM, Jr.: Have you written it down? Has it ever been explained?

Dr. Tugwell: No, I don't think so. Perhaps we ought to.

HM, Jr.: Do you have someone who could do that? Just take one page and show that this is the family we have in North Dakota and this is what we do for a North Dakota family.

Dr. Tugwell: It would not run by States but by individual families. They look at this fellow and say he is a one-horse farmer or a two-mule farmer.

HM, Jr.: Write down for any typical family in the Northwest and one typical family in the Southwest and show this is what we can do for them.
Dr. Tugwell: Sure. Be glad to.

HM. Jr.: Last year I took one week and every morning Hopkins brought over another man. We took two hours every morning. For one solid week we took two hours a day for him to explain the kind of work in each division.

Dr. Tugwell: How is your week now?

HM. Jr.: Not such a good week.

Dr. Tugwell: I will be glad to do that. We will be very glad to do it. You ought to take about five different people.

HM. Jr.: I can't do it now all five successive days. But if I gave 24 hours notice could you get the first fellow ready?

Dr. Tugwell: Be very glad to any time you say.

HM. Jr.: Then I would wait a couple of days and do another fellow.

Dr. Tugwell: I would like to get an understanding of the land program and Rehabilitation. The Rehabilitation is much the biggest.

HM. Jr.: I would love to do that too and maybe this $48,000,000 - I would like to have that explained first. Because here is this thing. I can't put my head in the sand and say this is perfectly lovely when you have 500 or 600 families. No provision has been made for them. I have not been in Washington for three years not to know what is going to happen. Can a person say, you don't have to worry about these families because they are already taken care of because he will get by?

Dr. Tugwell: I know you can't.

HM. Jr.: Do you know what I recommended for the President. This in confidence. I recommended one billion 960 million dollars for relief for the fiscal year beginning July 1st and 100 million for Resettlement. That was my recommendation.

Dr. Tugwell: We are in such shape now that 100 million dollars would not do it because it costs so much to put our lands on the Resettlement Construction projects. We are over 20 million dollars short.

HM. Jr.: You mean you have contracted for that much more than you got?

Dr. Tugwell: Yes. We had money when we started.

HM. Jr.: How many of those projects are there?
Dr. Tugwell: About 70 active ones.

HM.Jr.: That is your satellite cities?

Dr. Tugwell: No. We only have three of those going on - Milwaukee, Cincinnati and Beltsville. Bound Brook is an active one.

HM.Jr.: I thought it was agreed you would start one at Buffalo? You killed Chicago.

Dr. Tugwell: That was never active.

HM.Jr.: You mean you have actually signed contracts for people for construction work as we do in Procurement?

Dr. Tugwell: No. They are not contract jobs. The only problem will be that there are houses standing out in the field that have not been done.

Mr. Bell: But your suburban stuff is in pretty good shape now?

Dr. Tugwell: Except for out here in Berwin.

Mr. Bell: The only thing you have not been able to do is extend it, but you have brought your limit of costs down to funds available.

Mr. Baldwin: It was necessary to make that transfer to Berwin. We increased the limit on Berwin.

Mr. Bell: Was it not 26 million we said over last week?

Mr. Baldwin: Yes.

Mr. Bell: That brings them all within the fund?

Mr. Baldwin: Yes.

Dr. Tugwell: You got your original 58 million approved by the President, Dan?

Mr. Baldwin: We still have 58 million not approved projects but we don't have the money to start.

Dr. Tugwell: I have a date with the President. I must go.

HM.Jr.: I have about covered the thing, Dan, do you want to send someone over or should I have Oliphant send one of his lawyers?

Mr. Bell: If you are going to send someone on land contracts I think you ought to send somebody .......... You had better send someone who understands politics.
Mr. Ball: Somebody handling land purchases for Procurement.

Mr. Jr.: Law is his name. And the first morning I know I am going to have some time, let us get together again.
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Regraded Unclassified
May 5, 1936

Hopkins and Bell met with the Secretary today. The following conversation took place:

Hill, Jr.: Supposing the Treasury said to you, We will take off all of the so-called red tape. Can you, out of the 4 billion & go through to July 1?

Hopkins: If the regulations are abolished and we get no further funds from the Treasury other than the $30,000,000 which is now in the hopper -- that is the 20 and 10 -- then we need no money until June 1. If the new bill is passed by June 1 and the money was available, there would not need to be further scraping of the 4 billion &. (See Exhibit "A" attached for this paragraph and for numbers 2, 3 and 4 following.)

(2) If the restrictions are left as they are and if the bill is signed and the money made available by June 1, we would require $195,000,000 more money.

(3) If the bill is signed by June 15, PWA would require $280,000,000 additional, representing an increase of one-half month's cost or $85,000,000 over the $195,000,000 estimated for June 1.

(4) If the bill is signed on July 1, PWA will require a total of $365,000,000 estimated on the same basis as above.

Mr. Bell: What would you do with $365,000,000?

Mr. Hopkins: That is all because of the restrictions. It is not because we would spend it.

(Attached are other statements left with Mr. Morgenthau by Mr. Hopkins.)

Mr. Hopkins: In my own opinion, there is not enough money available that Dan can get transferred from other agencies which will keep our stuff going until the new bill is passed.

Hill, Jr.: You are going to have to nick this $1,500,000,000 for about $100,000,000 prior to July 1? After July 1, it will be easier for Dan to get hold of some of this money, but I think $100,000,000 is going to be obligated prior to July 1. Let's say that these regulations are off, Dan, and Harry has allocated to him 1 million 4, then what you say is that the
men will have done the work in June and it will be owing to them for work done in June and that they will not be paid until sometime in July?

Mr. Bell: Yes. The obligation is incurred in June, but not liquidated until July.

HM, Jr.: What I am trying to get out of this meeting is to find a way out. From the President's standpoint, it is a tremendous mistake to have to admit that part of the $1,500,000,000 is spent prior to July 1. The fact that it is obligated does not "cut any ice." The work is done and we owe the money to the men.

According to your own figures, then, as stated on sheet No. 2 (Exhibit B), we are $80,000,000 apart. In other words, if you had another $80,000,000 turned over to you, you would not need any of the $1,500,000,000.

Mr. Hopkins: Yes -- 80 million in addition to the 30 million.

HM, Jr.: What I would like to do, and I can only do it with your help, is to have one more session with the President to see if we cannot get another $80,000,000 for you.

Mr. Hopkins: I think in Tugwell's shop there is 25 million that Dan has hung up on a peg. I think this could be transferred to me if there was a firm commitment that this work would be done later. Then take the 25 million out of the $1,500,000,000 and give it to Tugwell.

Mr. Bell: This cannot be done. The way the thing stands now is that Tugwell will not get any of this $1,500,000,000 and Hopkins will have to take over Tugwell's organization and complete the Resettlement Program. I think the President could transfer Tugwell's money to Hopkins now, which he can use to take him through to July 1. Then when Hopkins gets the $1,500,000,000 on July 1, he can reimburse "Resettlement Program" what he borrowed to use for his own shop.

HM, Jr. told Mr. Hopkins to go into Bell's office and talk the thing through further and arrange for another meeting on Thursday at 11:30.
ESTIMATED AMOUNT OF FUNDS NEEDED BY WPA

Assuming That Present Financial Procedure is not Revised

Experience indicates that under present financial procedure balances must be kept in the states at least six weeks in advance of actual obligations. This is caused, of course, by the necessity for setting up encumbrances for each of the 50,000 projects in operation. On this basis the estimates are as follows:

If the Bill is signed June 1, WPA would require a total of $195,000,000 additional, representing the $110,000,000 additional funds needed through June plus one-half month's requirement of $85,000,000.

If the Bill is signed June 15, the WPA would require $280,000,000 additional, representing an increase of one-half month's cost of $85,000,000 over the $195,000,000 estimated for June 1.

If the Bill is signed on July 1, the WPA will require a total of $365,000,000, estimated on the same basis as above.
ESTIMATED AMOUNT OF FUNDS NEEDED BY WPA

Assuming that Present Financial Procedure is Revised

If the revised financial procedure is agreed to, the WPA will need the following sums in addition to the $1,402,000,000 allocated as of April 20 ($30,000,000 has been signed by the President and is now pending).

These estimates are minimums on the assumption that the funds could be obligated on a theoretically perfect basis in each State and in each District.

If the new appropriation is signed June 1, present funds, including the $30,000,000 pending, should be sufficient. Realistically, however, there should be at least $10,000,000 available to meet acute situations that are inevitable in certain States no matter how carefully the money is allotted.

If the Bill is signed on June 15, the WPA will need an additional $85,000,000, or $55,000,000 in addition to the $30,000,000 pending. A similar margin of safety of $10,000,000 additional should be allowed at this point.

If the Bill is signed on July 1, the WPA will need $110,000,000, or $80,000,000 in addition to the $30,000,000 now pending.
WORKS PROGRAM EMPLOYMENT

<table>
<thead>
<tr>
<th></th>
<th>TOTAL</th>
<th>W.P.A.</th>
<th>C.C.C.</th>
<th>ALL OTHER</th>
</tr>
</thead>
<tbody>
<tr>
<td>Feb 15</td>
<td>3,619,000</td>
<td>3,018,000</td>
<td>467,000</td>
<td>334,000</td>
</tr>
<tr>
<td>Mar 14</td>
<td>3,845,000</td>
<td>3,000,000</td>
<td>449,000</td>
<td>396,000</td>
</tr>
<tr>
<td>Apr 16</td>
<td>3,588,000</td>
<td>2,654,000</td>
<td>403,000</td>
<td>521,000</td>
</tr>
<tr>
<td>May 15</td>
<td>3,445,000</td>
<td>2,450,000</td>
<td>395,000</td>
<td>600,000</td>
</tr>
<tr>
<td>Jun 15</td>
<td>3,400,000</td>
<td>2,550,000</td>
<td>390,000</td>
<td>660,000</td>
</tr>
</tbody>
</table>

**Note:** W.P.A. Obligations will not vary in exact relationship to employment because:

1) Payrolls must be met after an employee is separated up to the amount already earned by that employee.

2) Erratic fluctuations in material purchases, method of obligating payrolls, and other technical considerations.

May 5, 1936.
**WPA FUNDS**

*April 20, 1936*

Total allocated                                  $1,402,000,000
Obligated                                        $1,107,000,000
Unobligated                                      295,000,000
Estimated requirements
  April 20 – June 30                              405,000,000

Additional funds required to June 30             $110,000,000
Now pending                                      30,000,000
Additional funds*                                80,000,000

Total allocated as of June 30                    $1,512,000,000

*This sum is estimated on an actual obligated basis and assumes that the proposed change in financial procedure will be effectuated in order to allow flexibility in the use of funds within each limitation of the Act within a State.*
## OBLIGATIONS AND EXPENDITURES FOR WPA PROGRAM

<table>
<thead>
<tr>
<th></th>
<th>Obligations</th>
<th>Checks Issued</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Monthly</td>
<td>Cumulative to end of Month</td>
</tr>
<tr>
<td>Actual</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sept. 30</td>
<td>61,410,000</td>
<td>61,410,000</td>
</tr>
<tr>
<td>October</td>
<td>74,724,000</td>
<td>136,194,000</td>
</tr>
<tr>
<td>November</td>
<td>117,400,000</td>
<td>253,594,000</td>
</tr>
<tr>
<td>December</td>
<td>189,206,000</td>
<td>442,800,000</td>
</tr>
<tr>
<td>January</td>
<td>178,381,000</td>
<td>621,181,000</td>
</tr>
<tr>
<td>February</td>
<td>182,677,000</td>
<td>803,858,000</td>
</tr>
<tr>
<td>March</td>
<td>188,495,000</td>
<td>992,353,000</td>
</tr>
<tr>
<td>(April - 20 days)</td>
<td>114,346,000</td>
<td>1,106,699,000</td>
</tr>
</tbody>
</table>

| Estimated      |                                  |                                    |                                  |                            |
| April (30 days)| 180,000,000                      | 1,172,353,000                      |                                  |                            |
| May            | 172,000,000                      | 1,344,353,000                      |                                  |                            |
| June           | 165,000,000                      | 1,509,353,000                      |                                  |                            |

May 5, 1936
Estimated Cost of WPA - May.

State projects .................. $150,000,000
NYA ............................ 7,000,000
Federal - WPA .................. 6,000,000
Administration .................. 6,000,000
Land Utilization
Resettlement Administration .. 3,500,000

Total .......................... $172,000,000
### STATUSES OF FUNDS ALLOCATED TO SPECIFIED AGENCIES

**April 20, 1936**

<table>
<thead>
<tr>
<th>Agency</th>
<th>Allocations</th>
<th>Obligations Incurred</th>
<th>Checks Issued</th>
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<tbody>
<tr>
<td>Works Progress Administration</td>
<td>$1,401,778,000</td>
<td>$1,106,699,000</td>
<td>$896,457,000</td>
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<tr>
<td>Resettlement Administration</td>
<td>230,396,000</td>
<td>137,775,000</td>
<td>88,791,000</td>
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<tr>
<td>Public Works Administration Non-Federal</td>
<td>346,105,000</td>
<td>318,331,000</td>
<td>59,071,000</td>
</tr>
<tr>
<td>Public Works Administration Housing</td>
<td>101,373,000</td>
<td>27,169,000</td>
<td>15,801,000</td>
</tr>
<tr>
<td>Puerto Rico Reconstruction Administration</td>
<td>33,377,000</td>
<td>6,566,000</td>
<td>3,272,000</td>
</tr>
<tr>
<td>Treasury Department</td>
<td>54,241,000</td>
<td>26,919,000</td>
<td>24,832,000</td>
</tr>
<tr>
<td>Reclamation Bureau</td>
<td>76,680,000</td>
<td>38,826,000</td>
<td>10,023,000</td>
</tr>
</tbody>
</table>

**May 5, 1936**
HM, Jr. told McReynolds today that if the State Department wants to make another move with the Canadians about the liquor situation, it is agreeable to him, but he wants a letter or a promise from Secretary Hull and nobody else that beginning with Monday we can go ahead, full steam. He wants the backing of the State Department on this bill to go ahead on Monday.

***

HM, Jr. told Bell that he saw the President at lunch yesterday and put the following proposition to him: that he would see Hopkins today (Tuesday) and tell him that if he spends $75,000,000 in June or $25,000,000 out of the $1,500,000,000, everybody is going to say, "Not only will the $1,500,000,000 not last, but they have nicked it already in June. It is all a fake. It will not even last six months." The President said, "What do you want? Are you willing that I drive a bargain with Harry that if he will not spend a nickel out of the $1,500,000,000 this year, we will raise the barriers?" HM, Jr. said, "I think it would be a terrific mistake if he starts spending out of the $1,500,000,000 this year," and the President said "O.K."

HM, Jr. then said to the President, "I have sent a lawyer over to Tugwell to check up and see if all of the $48,000,000 which he has to spend on the purchase of land has been obligated and if not, they should cancel the un-obligated balance." The President approved.
Hello -
Cochran: Hello -
HMjr: Cochran?
C: Yes, Mr. Morgenthau -
HMjr: Good morning
C: Good morning, sir
HMjr: How are you?
C: Quite all right
HMjr: What's new?
C: The morning started out rather quietly -
HMjr: Yes
C: - up until noon the Guaranty had sold only three million dollars -
HMjr: Yes
C: - as compared with six yesterday noon.
HMjr: Yes
C: But I just talked with the Guaranty now and with Cariguel -
HMjr: Yes
C: They both report much greater activity since twelve o'clock.
HMjr: Now, what does that mean?
C: Up until this hour - it's now three o'clock here - it has done nine million alone.
HMjr: Who has?
C: The Guaranty
HMjr: Has done nine million?
C: Yes - Yesterday all day they did thirteen.
HMjr: What's that?
C: I say, during the whole day yesterday the Guaranty did thirteen million –

HMjr: Well, does that mean that from now on – I mean today it's gotten worse?

C: Since noon it has gotten worse than this morning and is going at about yesterday's rate now.

HMjr: At about yesterday's pace?

C: Yesterday's speed –

HMjr: Yes – yes

C: Because having been nine now they'll probably reach thirteen by evening.

HMjr: Yes – hello –

C: National City is the only other one in.

HMjr: Yes

C: In the market. The British control is intervening actively –

HMjr: Yes

C: And having a big day at seventy-five and seven sixteenths.

HMjr: Yes

C: The same rate at which they yesterday.

HMjr: Well, it's – we figured it out – yes, yes – now –

C: Seventy-five and seven sixteenths –

HMjr: Now, let me ask you something, have you seen Criguel today?

C: I talked with him on the phone just a while ago –

HMjr: Yes

C: But I am going to see him at half past five this evening.

HMjr: You are going to see him when?

C: At half past five.

HMjr: Yes
C: I saw him yesterday morning, - you know? Have you got that message?

HMjr: Now - hello?

C: It's a summary of today.

HMjr: Yes - hello?

C: Hello - It's a Cochran message in which is summarized the day's developments.

HMjr: Yes - they - Lochhead got that late last night.

C: Well, I'll - I'll send this other one right fast for Tuesday.

HMjr: You will?

C: Yes - I'll see him at five-thirty.

HMjr: Yes

C: Yes - I'll see him at five-thirty.

HMjr: Yes

C: And the Cabinet meeting is going to be at four-thirty this afternoon.

HMjr: Four-thirty?

C: I talked with Baumgartner -

HMjr: Yes

C: - of the Ministry of Finance at noon.

HMjr: Yes

C: And at that time he did not think any important decision could be taken this afternoon.

HMjr: He doesn't think so?

C: No, but of course this financial situation has gotten worse since the three hours ago.

HMjr: Yes

C: But whether its had enough to cause them to take any decision yet I doubt.

HMjr: Well now -

C: The Ministry, you know -
Hello?

Hello -

Let me ask you -

must not put any restrictions on

Now, wait a minute, I want to ask you a question.

Yes

Do you think that the present cabinet will continue until June one?

It depends entirely on this monetary development.

What's that?

It depends entirely on this franc situation.

I see.

If this run continues as it has yesterday -

Yes

and today I do not think this Cabinet can last.

This what?

I do not think this Government can stay in until June.

I see.

If this pressure lets up the next day or two I think they will continue it.

Yes - well -

But I do not think this Government ought to take any restrictive measures -

Yes

If restrictive measures seemed imperative they would probably step out and leave it to the Socialists.

They would?

Yes, now that's the way it looks today.
Well, in other words if this gold continues --

C: Yes

HMjr: the chances are that the Cabinet will be forced out?

C: That's it, yes.

HMjr: I get you.

C: Yes

HMjr: Well now, don't hesitate, if anything happens from the Cabinet or anything from Cariguel - use the telephone.

C: I didn't get your last sentence.

HMjr: If anything important happens use the telephone.

C: Surely.

HMjr: Yes

C: But I'll see my friend at five-thirty -

HMjr: Yes

C: a Cabinet meeting a little later.

HMjr: Well, you'll see him in what - about three hours?

C: Yes

HMjr: O. K.

C: And if there's anything urgent I'll telephone - if not I'll send a rush message.

HMjr: Yes

C: Summarizing it.

HMjr: All right

C: Goodbye

HMjr: Thank you - goodbye.
I called Mr. Cariguel at 11:33 a.m. today. He stated that morning had been fairly quiet in Paris but that since noon the drain on them was heavy again. The British had up to then done 250,000,000 lbs and in addition $20,000,000 worth of gold had been engaged for shipment to New York and that was not the end yet. Belgium was also sending some gold from them but neither the Swiss nor the Dutch rate had reached gold point. Shipments to New York were moving smoothly and some of the gold was being diverted by aeroplane to London and Holland. There was no evidence of hoarding by the public in France; nevertheless, as the figures indicated, export of capital was going on on a large scale. I asked whether the gold was being paid for in hoarded notes or entirely in means of discounts. Cariguel thought that whilst some of the hoarded notes might be coming back for conversion into gold the bank's portfolio would undoubtedly show a heavy increase.

I made reference to rumors that Spain was shipping gold to Paris. Cariguel confirmed this; he added that the amount was only small, the shipment consisting of gold coin which the Spanish Central Bank was selling to the public in Paris in order to take advantage of the premium on coins.

I spoke of the cabinet meeting which, according to reports received here from Paris, was now being held there and asked whether, in his opinion, the present government would stay in until the end of the month and if so, whether they would continue their present policy.

Cariguel replied that he did not of course know how long the old government would last but expressed the opinion that as long as it was in office it...
would defend the franc as heretofore. If the pressure became too
trong, they might turn the helm over to the next fellow. With regard
to the "new people" he thought they would be quite tame and tolerant.

I asked Cariguel, if at all possible, to keep me posted as to developments and he promised he would do his best.
May 5, 1936

At Taylor's house, last night, Bewley told me that he did not wish to take advantage of seeing me at dinner, but he wanted me to know that he had cabled to England my query and had received no answer. He evidently was quite embarrassed that he had not received an answer. I assured him that I had gone Chinese in my philosophy and that a week or a year meant very little to me. I told him it seemed unfortunate that we could not be civilized and have a channel open to exchange information. He completely agreed with me. The whole conversation was, on the surface, in a very light vein, but underneath both of us were very serious.

He asked me whether he could have any information on the Chinese negotiations and I told him that he would have to be patient for a few more days as we could not give him any information until the negotiations were completed. I said to Bewley, "I can tell you this; our negotiations are not selfish and our motives are in the best interests of China." He also made a funny remark. He said, "What do you hear about Leith-Ross?" and I said, "Very little." He said, "Well, don't you know what he is doing?" and I said, "No; don't you?" He said, "They don't keep me informed at all."

If Bewley did not get the point of my conversation when he was at the office, namely, that I was trying to open a channel to exchange information, he certainly got it last night. He said, "What do you think is going to happen in France? Do you think they will devalue?" and I said, "I think their first move will be an embargo on gold and that will not be so good for England, will it?" And he said, "No," and I think I implied at that point that if this happens it would be useful to have a channel opened to exchange information. Taylor added that before Bewley left he said to him, "I certainly think it would be desirable to have a channel open."

***

HM, Jr. called the President at 9:20. This is their conversation:

"I just talked to Paris and the Cabinet meets at 4:30 Paris time. That is in about two hours. The situation,
to boil it down, is this: if the monetary situation continues as acute as it is now, they have got to do something, because it is going so fast. Up to noon it did not go so rapidly and suddenly it took another spurt. Cochran feels if the pressure on the franc continues, then the Cabinet has to do something. This Cabinet does not want to do anything and, therefore, they will resign. If the pressure lets up, they will continue until June 1. Our guess is that they will not do the clean-out thing (go to an immediate devaluation) but they will embargo."

He told the President that he was at Taylor's house last night for dinner and that Bewley was present. HM, Jr. related to the President their conversation as it is recorded on page one herewith.

HM, Jr. then told the President the following: "The thing that you and I have to make up our minds about is this: if this gold continues to come in, the American banks and the American steamers will be filled up and the Bank of France will most likely ask us for help, and the question is, Do we want to help them? They have not asked us yet."

The President then asked, "What would happen if we would not let this gold in? Where would it go?" HM, Jr. said the franc would go down and Sterling would go up. "That would not bother us much, but it would be very embarrassing for England and it might force them to come and see us. Our only worry is when Sterling begins to drop and as long as it goes up, why worry? My only feeling is that I want to see this thing cleaned up and I just feel that France has to do it sooner or later and if we give them another artificial stimulant to tide them over, it will not do them any good."

The President then said, "In 1935 I believe we brought in about 1 1/2 billion dollars' worth of gold. This year we will bring in another billion dollars' worth. Gradually we will drain the whole supply. Then where are we? It is a little bit like the banker in a small community who begins to foreclose on a house. He gets the property. Then another house is foreclosed, and another one, and he gradually gets half of the land in the community. What happens? He takes the land out of circulation. Finally he gets three-fourths of the land. Then there is no market, because the land is out of circulation. Instead of profiting by his
purchases, he is left holding all the land without any market and, therefore, it isn't worth anything? I feel that way about gold."

The President asked, "What are the mechanics? Just how do we do this?" HM, Jr. replied, "The various banks, like the Guaranty, the Chase and the Bank of Manhattan, let's say, take $50,000,000. The banks have reached their limit when they purchase that amount because they can only take 25% of their capital and surplus. Then the Bank of France asks the United States Government, 'Will you not buy some gold and hold it in France until there is another boat?' And we say, 'We are on an international gold bullion standard and we can't take it any faster than the boats can bring it in. Of course, Mr. President, they have not asked us yet, but the above will be the procedure should this ever come about."

He also said to the President, "By the way, the Chinese again gave us a demonstration. They detached their money from Sterling and they attached it to the Dollar, and they have kept their word. They said they would operate between the two and today they did it. Their memorandum is in and we are going over it and any time you want them now for tea, you can ask them and be very friendly to them."

* * * *

Those present at the 9:30 meeting were McReynolds, Upham, Miss Roche, Gibbons, Has, Taylor, Oliphant and Bell.

The Secretary discussed the case of the two men who were killed working on a Post Office building at San Antonio. He asked McReynolds to investigate the condition of their families, one of whom was a married man. The Secretary wants a bill introduced for the relief of the men's families, due to the fact that because of Government "red tape" there is no compensation provided for accidents of this sort. The bill would be similar to that suggested by the Secretary and passed by Congress for the relief of Mrs. McClary, whose husband, a policeman of Alexandria, Va., was killed while assisting the Alcohol Tax Unit in capturing a mountaineer moonshiner.

HM, Jr. turned over to Mr. Oliphant the resolution intro-
duced by Senator King and referred to the Secretary, under the terms of which the President would be authorized to extend to the Government of America, including the Dominion of Canada, an invitation to attend a silver conference, and asked Oliphant to look into it, but added, "I really think we just ought to stall on this."

The Secretary had before him a letter from Secretary Roper inviting the Secretary to name a representative on a board of three which would conduct an investigation of charges made by striking seamen, concerning laxity on the part of the Inspection Service of the Department of Commerce. He also had a letter from Senator Copeland asking that Admiral Hamlet be named to a board which has been authorized by Senate Resolution authorizing the Senate Committee on Commerce to make recommendations for necessary legislation covering the safety of life at sea. (Copies are attached.)

HMJr. turned these letters over to Mr. Gibbons and told him that, in connection with Roper's letter, he did not want the Treasury to be part and parcel of a whitewash board. He suggested the following to Mr. Gibbons: "You go over and see Roper yourself, and tell him in the nicest way you know how that if he wants a representative of the Treasury, O. K., but he must be prepared that we will not 'pull our punches' and we will say just what we think, and unless he is prepared to have us take that attitude, not to include a Treasury representative on the Board."

Gibbons reported to the Secretary that he had received a letter from a member of the Speakers' Bureau of Democratic Headquarters, and others in the Treasury had received a similar letter, including Jack Harlan and Herman Oliphant, asking them to make campaign speeches. He added that he felt the situation was becoming very serious. The Secretary said he wanted to meet with his "Political Committee" either Wednesday or Thursday evening of this week at his home and would make a definite appointment tomorrow.

In connection with the question raised by the Secretary at yesterday's group meeting, concerning possible loopholes in the pending tax bill and their "plugging", HMJr. received last night at his home the following memorandum from Oliphant:

"After the morning meeting on the tax bill, worked on Harrison's suggestion of two slight changes to enable him to have the bill reported favorably."

"With Upham and Kent, saw Beaman, Parker and other
legislative experts at and after lunch to make a recheck on possible loopholes. I might say that our own experts on this are Messrs. Turney, Kent and Lusk, and possible loopholes have occupied most of their time since March first.

"Turney and Kent confirmed my statement this morning that all major loopholes have been plugged, and there remain only those miscellaneous minor possibilities of avoidance, possibilities which we always have in the case of any general tax bill.

"My recanvas of possible escapes with Beaman, Parker and O'Brien was not completed because of a special matter I shall mention below; although on general inquiry they referred only to Section 27(1) relating to intercorporate dividends which will have to be reworked because of the last minute amendment in the House making the dividend year the same as the taxable year.

"Instead of Harrison's suggestion of a flat exemption of $3,000 for corporations with net incomes of less than $20,000, Parker suggested that we adopt one table (that with the higher rates), let corporations figure their tax under it, and then tax corporations with incomes of less than $15,000 or $20,000 that fraction of the tax so calculated which their income is of $15,000 or $20,000. Much time was spent discussing this possibility of meeting Harrison's request for simplification, and it looks promising. George and I worked on it some this afternoon, and it looks as if it might be adopted without any loss of revenue.

"I might add generally that having gone through this whole process in the preparation of the Revenue Act of 1934, and the Revenue Act of 1935, and knowing how our own staff and the two staffs on the Hill work, things are moving and are being handled in the usual way, and, as usual, the process of perfecting the bill will continue until final enactment.

"Dr. Feis called me about a cablegram from Flack relative to the transfer of Brenner in Waite's office in Paris to Boston. I relayed the message to Gibbons as Feis requested."

MJ, Jr's comments to Oliphant were as follows: "You assumed the responsibility of the tax bill and I am willing to rely on your judgment that you have it in hand. I place my reputation in your hands. You have not abused it yet. However, as people call various things to my attention, I will bring them to you. We are gambling to the extent of $1,250,000,000 in revenue and you fellows must be triply sure that you are right. I leave it entirely to you and Haas."
Governor Myers sent a letter to the Secretary (copy attached) in which he asked that if the building at 40th 13th Street should become available, it be turned over to Farm Credit for garage and storage space. HM, Jr. turned the letter over to McReynolds to investigate and McReynolds reported today that it is one of the buildings of which the Treasury is custodian and that at present this building is leased to A. W. Mellon. He felt it would be an opportunity for Republicans to hint of "persecution" and would be 100% wrong to take it away from Mellon. HM, Jr. said that absolutely the Treasury was not to take the property away from Mr. Mellon, who leases it for garage space.

Bell mentioned the controversy between Crowley of FDIC and the Comptroller's office over bills in Congress sponsored by Mr. O'Connor. Bell said that Crowley had called S. 4513 to his attention as being inimical to the interests of FDIC and asked Bell if it had been cleared through the Budget and Bell said it had not been. The Secretary asked for a memorandum on S. 4513, which Bell said he would submit. (Memo is attached hereto.)
Mr. King introduced the following joint resolution; which was read, twice and referred to the Committee on Foreign Relations.

JOINT RESOLUTION

Authorizing the President to extend to the governments of America, including the Dominion of Canada, an invitation to attend a silver conference.

1. Resolved by the Senate and House of Representatives of the United States of America in Congress assembled,

2. That the President is authorized to extend to the governments of America, including the Dominion of Canada, an invitation to attend a conference for the purpose of considering and devising plans to increase the use of silver for monetary and other purposes, to bring about stabilization of the price of silver, and to formulate a uniform policy for such governments with respect to silver.
SEC. 2. The sum of $100,000, or so much thereof as may be necessary, is authorized to be appropriated for the expenses of such conference, including salaries in the District of Columbia or elsewhere, rent, printing and binding, printing of official meeting cards, travel and subsistence, or per diem in lieu of subsistence (notwithstanding the provisions of any other Act), stenographic and other services by contract if deemed necessary, and such other expenses as may be deemed necessary by the Secretary of State by reason or such conference.

JOINT RESOLUTION

To authorize a special conference.

Whereas it is necessary that there be a conference of the officers of the Treasury, the Post Office Department, and the several State government to be held in the District of Columbia, or elsewhere, for the purpose of considering the proposed renunciation of the assistance granted the several States by the United States for the purpose of enabling them to meet and to pass upon the necessary and proper measures for the payment of the foreign debts of the United States: Now, therefore, be it enacted by the Congress of the United States of America, that the sum of $100,000 be and is hereby appropriated for the purpose aforesaid.

Approved March 2, 1874.
S. J. RES. 254

JOINT RESOLUTION

Authorizing the President to extend to the governments of America, including the Dominion of Canada, an invitation to attend a silver conference.

By Mr. King

April 24 (calendar day, April 27), 1966
Read twice and referred to the Committee on Foreign Relations
May 5, 1936

At Taylor’s house, last night, Bewley told me that he did not wish to take advantage of seeing me at dinner, but he wanted me to know that he had cabled to England my query and had received no answer. He evidently was quite embarrassed that he had not received an answer. I assured him that I had gone Chinese in my philosophy and that a week or a year meant very little to me. I told him it seemed unfortunate that we could not be civilized and have a channel open to exchange information. He completely agreed with me. The whole conversation was, on the surface, in a very light vein, but underneath both of us were very serious.

He asked me whether he could have any information on the Chinese negotiations and I told him that he would have to be patient for a few more days as we could not give him any information until the negotiations were completed. I said to Bewley, "I can tell you this: our negotiations are not selfish and our motives are in the best interests of China." He also made a funny remark. He said, "What do you hear about Leith-Ross?" and I said, "Very little." He said, "Well, don’t you know what he is doing?" and I said, "No; don’t you?" He said, "They don’t keep me informed at all."

If Bewley did not get the point of my conversation when he was at the office, namely: that I was trying to open a channel to exchange information, he certainly got it last night. He said, "What do you think is going to happen in France? Do you think they will devalue?" and I said, "I think their first move will be an embargo on gold and that will not be so good for England, will it?" And he said, "No," and I think I implied at that point that if this happens it would be useful to have a channel opened to exchange information. Taylor added that before Bewley left he said to him, "I certainly think it would be desirable to have a channel open."
Mr. Bolton called me at 2:20 p.m. and talked to me along the following lines:

"What we have in mind at the present moment is this: There is a very heavy flow of gold from Paris to New York and Cariguel is having a very difficult time to keep the dollar rate down to 1519. We have an order from you to buy gold at $54.77 an ounce. Would it interest you at all to divert some of the present flow from Paris to New York and have us hold the gold here for your account? Our assumption is that you want to prevent some of the movement of gold from Paris to New York. At the present moment, with gold quoted here at above $54.90, we cannot of course work at your limit of $54.77 in London. Would you be interested in having us buy gold for you in Paris at $54.77 plus cost of shipment from Paris to London, or at a total of about $54.80? As I said before, Cariguel wants to keep the dollar rate in Paris down. At the clip at which the gold is moving out now it will soon be a question of finding accommodation on steamers. If a lack of shipping facilities should develop, the rate is likely to go up. If you are not in a position to pay more than $54.77, it may of course be possible for us to work at that figure after the dollar in Paris has broken through 1519. If $54.80 or thereabouts is too high for you to pay, maybe you can think of a counter proposal."

I told Bolton that we would of course discuss his suggestions with Washington but that I was a little doubtful because if we acted on his suggestion the gold would stand us more than $55 per ounce if, subsequently, it had to be removed from London to New York. As long as the
to say.

offhand naturally, nobody knew whether that was or not what he was going on the effect that gault was going to make a statement after new york's notice on then mentioned that a story was going around in london

and yet seem

the least effect upon the farm was the most serious one we

were probably in excess of 600,000$ francs and repeated that. in this

gold. he agreed with me that the bank of england's entire loss of gold today

were a little better than that and that, in addition, belgium had taken

about 200,000$ francs. gault repeated that their purchases

close to 650,000$ and that we understood the british pound and our-

that we had heard of gold surrenders for shipment to new york totaling

the pressure on francs today was higher than ever before. i remembered

then urgent about the situation in france. gault thought

that of a counter proposal. if any came, he hoped i would do my best

that if we could not pay more than $64.77 we might perhaps be able to

gault repeated that he had just wanted to put the idea into our mind.

discussion here, to get in touch with the other by cable or by telephone.

exactly what we were trying to accomplish. i promised, after further

and thus be proceeded from coming over here it seemed to me that was
cured particularly where they thought it. if it were bought in paris

place for delivery in london did not exceed our limit that i did not think we

FEDERAL RESERVE BANK
May 5, 1936

Walked home with the Secretary this evening in order to discuss two questions which came up this afternoon.

(1) The Bankers Trust Company, New York, received a cable from their London Office asking whether gold could be shipped from the United States to Great Britain by new regulations of the Secretary of the Treasury or whether further legislation would be necessary to allow such shipments. The Bankers Trust Company, New York, gave a copy of this cable to the Federal Reserve Bank of New York, who in turn notified us without advising the Bankers Trust Company that it had been brought to the Treasury's attention. Such shipments could of course be made by regulations issued by the Secretary without further legislation, but it was thought significant that this point should be brought up by the Bankers Trust Company at this particular time.

(2) The Bank of England called the Federal Reserve Bank of New York regarding the order placed with them to purchase gold in the London market at $34.77 per ounce, and a memorandum covering this telephone conversation is attached hereto. Mr. Knock was advised to inform the Bank of England that $34.77 was the maximum price which could be applied to our order to buy gold in London as any price higher than $34.77 would raise the cost of this gold when delivered to the United States to over $35 an ounce. It was decided not to make any counter proposition such as suggested by the Bank of England. As American banks are apparently taking care of the gold movement from France to the United States in a satisfactory and normal manner, the implication by the Bank of England that the Bank of France required some help in maintaining the dollar franc rate does not seem warranted. Another
reason for a refusal to raise our buying rate above $34.77 for gold delivered in London but purchased in France is that this would mean that we would be paying a higher rate for gold in Paris than the commercial banks were doing at the present time.
Associated Gas
and
Electric

May 5, 1936
Wideman's memo to Secretary outlining present status of case and requesting interview to settle policy matters.

May 27, 1936
Conference in Secretary's office with Mr. Frederick S. Burroughs, a Vice President of Associated Gas, and Dr. Starch, in which Mr. Burroughs protested against Treasury's activities in connection with Section 77-b.

August 21, 1936
Oliphant's status report. Negotiations under way looking to possible agreement which would terminate Court proceedings.

September 29, 1936
Mr. Oliphant's memo on latest development in case. Proposed settlement being submitted to Judge Mack.

November 19, 1936
Wideman and Oliphant conferred with Secretary. Associated Gas is endeavoring to arrange some procedure for lifting the Government's lien so they can do some refinancing. He also informed the Secretary of proposal to appointment a commissioner who would attend directors' meetings. Wideman said Court might suggest him, to which Secretary gave no answer or comment.

November 20, 1936
HM, Jr's telephone call with Landis suggesting Kent discuss with him the proposal to appoint a commissioner.

January 6, 1937
Oliphant's full memo on draft of stipulation with Associated Gas and Electric.

February 10, 1937
Oliphant's memo reporting on hearings in the chambers of Judge Mack in which Wideman made it clear Government was not a party to approval of stipulations and reserved right to protect not only assets of the company but to collect its tax.
May 5, 1936

The Honorable,
The Secretary of the Treasury.

My dear Mr. Secretary:

In conference with you several weeks ago you requested that I keep you in touch with developments in the Associated Gas and Electric Company case. I have talked to Mr. Oliphant about it from time to time. The attached memorandum will give you a general picture of the present status.

The 778 proceedings in New York have been very active. One phase went to the Circuit Court of Appeals. That Court entered an order on jurisdictional questions today. The taking of testimony on the question of insolvency will probably commence next week.

You will note from the enclosed memorandum that major questions of policy are involved as well as highly technical and complicated legal problems. Although there is no question of policy calling for an immediate decision, such questions will arise before long. I shall be glad to confer with you whenever you wish at such time and place as you may indicate.

Respectfully,

FRANK J. WIDEMAN,
Special Assistant to the Attorney General.
May 5, 1936

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The Secretary of the Treasury.

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Respectfully,

FRANK J. WIDEMAN,
Special Assistant to the Attorney General.
DEPARTMENT OF JUSTICE

May 5, 1936

In re: Associated Gas and Electric Company

(Taxes).

The Department of Justice entered the above matter on December 20, 1935, when Messrs. Oliphant, Jackson and Kent of the Treasury Department and Mr. Boyd of the Tax Division conferred with the Attorney General. That conference was in reference to action to be taken in the preservation of tax liens existing in favor of the Government and arising by reason of a jeopardy assessment in the approximate amount of $50,000,000. At the time of the conference there was pending before Judge Mack in the Northern District of New York an involuntary petition filed by certain creditors seeking the reorganization of the Company under Section 77B of the Bankruptcy Act, as amended.

On Monday, December 23, 1935, the Government asked, and was granted, leave to appear in the 77B proceeding as amicus curiae. Since that time we have carefully followed the proceedings in that case.

Upon the request of the Treasury Department we prepared and, on Monday, February 24, 1936, filed, in the Northern District of New York, a Bill in equity for the foreclosure of the tax lien. The Bill seeks (a) an injunction pendente lite to prevent the Company from disposing of its assets; (b) a receivership pendente lite to preserve the assets of the Company; (c) discovery as to the assets of the Company and their location; (d) a final decree enforcing the tax lien against the assets. The several defendants have filed general appearances and have filed motions to dismiss, and, in the alternative, to strike portions of the Bill.

A study has been made of the objections raised to the Bill and a memorandum of law embodying the results of that study has been prepared. The most serious question is whether a Bill to foreclose a tax lien on personal property falls within the general jurisdiction
of a court of equity. The contention will be made by the other side, no doubt, that the Government has a plain, adequate and complete remedy at law by summary process for distraint and sale. Our study convinces us, however, that the Bill is maintainable under the circumstances of this case. There may be minor objections to the Bill but these are easily curable by amendment. Of course, in the light of more complete investigation it may be deemed advisable to file an amended Bill.

There is now pending before the Congress a Bill to authorize the Federal District Courts to entertain suits for the foreclosure of tax liens on personal property. I have collaborated with the Treasury experts in the preparation of this Bill and Mr. Oliphant tells me that it has a good chance of passing at this session of Congress. It is deemed best to delay calling up for argument the Company's motions addressed to the Government's Bill of Complaint until Congress acts.

Assuming that the motions are denied, we will then be in a position to ask for an injunction pendente lite. The probabilities are that this will be granted. A somewhat similar injunction was granted by Judge Mack in the 77B proceeding last year. If we were successful in this, the Company would probably attack the validity of the assessment per se by answer. The anticipated ground of the attack is that the assessment is arbitrary and capricious; that the assessment was not arrived at through processes of reasoning which are requisite to the exercise of this discretion by the Commissioner. This, in my opinion, would present a justiciable question and the court would have the power to inquire into the truth of any such allegation.

Assuming that we would be able to overcome the hurdle last above referred to, we would then desire to seek the receivership aid prayed for in our Bill of Complaint. It seems doubtful that the court will grant this relief. The Company could urge upon the court many considerations against such drastic action. The Company could probably avoid the receivership by offering to deposit the securities subject to the lien with a designated depository to await the outcome of the suit. It seems logical to suppose that the court would be disposed to accept some such plan as an alternative to receivership. Once the validity of the lien is established the only judicial act necessary to dispose of the case would be to decree the sale of the property subject to the lien. The court might refuse to appoint receivers for this limited purpose. By this course
of reasoning I merely mean to suggest the difficulties in our path and not to suggest that no reasons exist for the granting of a receivership. In a sale of property of this magnitude, and in view of the fact that the Government is the complainant-lien holder, it would seem essential to have a receivership in aid of sale.

This brings us to the question as to what our attitude should be in reference to the 77B proceedings. If the bankruptcy petition is approved all other matters (except the proceedings before the Board of Tax Appeals) are automatically absorbed in the 77B proceeding. We could, of course, hold our equity suit in abeyance pending the outcome of those proceedings. If we pursued this course of inaction, our position would not be materially altered upon the approval of the petition. We would have no voice in the selection of trustees. We could (through the Secretary of the Treasury) reject any plan of reorganization which did not provide for the payment of the Government’s taxes in full; but we would have no voice in the formation of a reorganization plan and, hence, would not be in a position to insist that some provision be made for the thousands of holders of Class A and common stock of the Company. If we should intervene as a petitioning creditor, it is extremely doubtful that the other creditors could question the Government’s status as a creditor; if we do not intervene, and the petition is approved, any creditor and the trustees might attack the validity of the lien and the Government’s creditor status when we seek to prove the tax claim. This might, conceivably, necessitate proving the tax claim before the court instead of the Board of Tax Appeals and of proving the validity of the jeopardy assessment.

The indications are that the court will soon reach a trial of the issue of insolvency. We are now conducting a lengthy study of the authorities on insolvency and methods of proving insolvency. We have furnished the Treasury Department with a statement of approved formulae. That Department is assimilating its data on the issue as applicable to the several formulae. Mr. Harrill, who handled the Mail Fraud Investigation for the Federal Bureau of Investigation will be employed by Treasury to apply the factual data contained in his report to the issue of insolvency. This work has been under way for about one month and it will be at least another month before we can reach a tentative answer to the question of insolvency. The work is being conducted with two objectives in view: (a) First to determine if the Company is solvent or insolvent; (b) in the second place, if the Company is determined to be insolvent, to prepare the evidence thereon for use in court, as though the Government were
going to prove insolvency without any aid whatsoever from any other litigant. In other words, if the Company appears to be insolvent from our study, we are going to have the Government ready to make out its own independent case.

If our study shows the Company to be insolvent and our ability to prove that fact, this raises a serious question of policy. Shall the Government take active steps to secure the approval of the petition in the 77B proceedings? This positive action, if thought desirable, may be taken in one of two ways: The Government can offer proof and actively participate (a) as amicus curiae and in the nature of parens patriae; or, (b) as an intervening petitioning creditor.

The reasons in favor of active participation are three in number:

(1) To protect the present tax claim of the Government. If the tax, as finally redetermined, should be between fifteen and thirty million dollars, it is difficult to understand how such an amount can be collected from an insolvent company without either disrupting the System, injuring the Service, or further mulching the investing public. A reorganization under Section 77B would seem to afford the only alternative. (2) To protect the Government as to future taxes. The System's tax matters are handled very largely by a personal company of Howard C. Hopson. It is to Mr. Hopson's personal advantage to have the tax affairs of the System in a confused state. If this System can be restored to a solvent basis under capable and honest management, the Government will stand to profit very materially through prompt collections of true tax liabilities. (3) To afford some measure of protection to security holders and the general investing public. In past years the Company has succeeded in placing in the hands of the investing public vast amounts of more or less worthless securities. Much of this has been due to financial racketeering on the part of the management.

It is a very serious question as to what stage of the trial of the issue of insolvency the Government should take positive action. Naturally we would like to see as much as possible of the proof of the petitioning creditors before deciding that question. However, if the Government is going to proceed independently in the bankruptcy proceedings such action should not be too long delayed.

Respectfully submitted.

FRANK J. WIDEMAN,
Special Assistant to the Attorney General.
May 5, 1936

The attached legal opinion from the General Counsel's office was prepared in answer to the Secretary's question, Could the Secretary of the Treasury resign from the Board of Trustees of the American Red Cross?

Since the Secretary has decided, for the time being, not to resign, this opinion is being filed for record purposes.
TO Mr. Taylor

FROM Mr. Oppen, Acting General Counsel

You have requested my opinion as to whether the Secretary may, if he so desires, resign from the Board of Trustees of the American National Red Cross.

The American National Red Cross was reincorporated by Act of January 5, 1905 (title 36, U.S.C., secs. 1-15). Section 5 of the Act provides for the governing body, namely, the central committee, consisting of eighteen persons, and section 9 provides as follows:

"The endowment fund of the American National Red Cross shall be kept and invested under the management and control of a board of nine trustees, who shall be elected from time to time by the incorporators and their successors under such regulations regarding terms and tenure of office, accountability, and expense as said incorporators and successors shall prescribe."

It seems clear that the provisions of section 9 do not express or imply a mandate from Congress that the Secretary of the Treasury must serve as a trustee of the Red Cross.

The regulations promulgated pursuant to section 9 appear in a pamphlet last printed in September, 1931 and containing the charter, by-laws, and endowment fund regulations. Section 1(a) of the regulations provides as follows:

"The Board of nine Trustees of the Endowment Fund required to be chosen by Section 8 of the Act to Incorporate The American National Red Cross, as
amended by an Act of Congress, approved June 25, 1910, ought always to include the three public officers of the United States who, by regular appointment and confirmation, are in discharge of public duties as follows:

"1. The Secretary of the Treasury.
2. The Treasurer of the United States.
3. The officer of the United States Treasury Department who may from time to time be designated by the President of the United States as a member of the Red Cross Central Committee in pursuance of the last clause of Section 5 of the Act of Congress approved January 5, 1905.

"The President of the Red Cross be and he is hereby requested to notify the incumbents of the above-named offices of their designation by the Board of Incorporators of the American Red Cross to fill for the terms of their incumbency of the United States offices held by them respectively the three vacancies that will exist in the Board of Trustees on January 1, 1915, and after the said date to give similar notice as vacancies may occur among the United States officers referred to." (Underscoring supplied.)

By section 6 of the By-laws:

"The President of the United States shall, upon his acceptance, be ex-officio President of The American National Red Cross."

It would appear that the Secretary, the Treasurer, and the other Treasury Department official referred to are intended to be distinguished from the so-called "non-official members of the Board" which are provided for in section 1(b). That section provides, inter alia, that the terms of office of the six non-official members will be four years and that any vacancy that shall occur among them will be filled in a certain manner for the time to elapse before the next meeting of
the incorporators; and the three officials referred to above are listed, in the Report of the Board of Trustees for the fiscal year ended June 30, 1935, as "Ex Officio Members" (see page 161 of the Annual Report of The American National Red Cross for the year ended June 30, 1935).

The regulations contain no provisions relating to the manner of filling vacancies occurring among the three "official" members of the Board for the obvious reason that the persons referred to (the Secretary, the Treasurer, and the Treasury Department official serving on the Central Committee) are at all times the incumbents of official government positions and are, presumably, constantly available to fill the three official memberships among the nine members of the Board.

I have no information as to whether any one who, by virtue of his holding public office, has heretofore been designated by the President as a member of the Board of Trustees has ever declined to serve or has resigned from the Board after accepting the designation. However, the provisions of the regulations appear to be merely advisory — "The Board of nine trustees * * ought always to include the three public officers of the United States * * " — and there would appear to be no more than a definitely expressed desire of the incorporators that these three officials serve as trustees and no more than a voluntary acceptance of the "designation" by the officials mentioned, to serve without compensation. In the absence of a statutory mandate, which is entirely lacking in this case, there would appear to be no method whereby any person
could be legally required to fulfill the duties of a trustee or could be legally prevented from voluntarily retiring from the Board at any time (Briggs v. Speulding, 141 U.S. 132; In Re Guanacevi Tunnel Co., 201 Fed. 516; International Bank v. Faber, 86 Fed. 445; Fearing v. Glenn, 73 Fed. 116). In the usual instance, the duties of such an official are substantially similar to those of a director of a corporation and the performance of such duties is a purely voluntary matter with the individual in question, it being impossible as a practical matter to require a person, against his voluntary wishes, to exercise judgment and discretion in the fulfillment of duties and functions involved in the handling of an organization's funds or in its business problems.

Accordingly, it is my opinion that the Secretary may, if and when he so desires, resign from the Board of Trustees of the Red Cross.

[Signature]

Acting General Counsel

April 1956.
May 5th, 1936.

My dear Senator:

Thank you very much for your letter of May 1, with which you transmitted copies of letters you had written to Comptroller O'Connor and Jesse Jones concerning Leo T. Crowley.

Sincerely,

(Signed) H. Morgenthau, Jr.

Secretary

Hon. Burton K. Wheeler,
United States Senate.
My dear Mr. Secretary:

For your information, I am enclosing herewith copies of two letters which I am this day sending to the Hon. J. F. T. O'Connor, Comptroller of the Currency, and Hon. Jesse Jones, Chairman of the R. F. C.

Assuring you of my esteem, I am

G. Cordially yours,

Honorable Henry Morgenthau, Jr.

Secretary of the Treasury

enclosures (2)
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Mr. Secretary,

With kindest personal regards

[Text]

I understand that you have been given the opportunity to correct the report that was sent to you earlier. If you feel that the information you have received is not accurate, please let me know.

I would kindly ask you to give me a report on the matter. If the report is correct, I will appreciate it if you could forward it to me.

I am taking the liberty of writing to you with reference to the matter.

[Text]

If you feel that there is anything lacking in the report, please let me know.

I am informed that the money was brought out of the bank by some of the persons who have been engaged in the transaction, and that the money had been placed in the account of one of the persons who have been engaged in the transaction.

If there is anything which I need to refer to the matter, please let me know.

[Text]

I was recently in the Federal Reserve before a decorative

[Text]

My dear Secretary,

[Text]

[Signature]

[Date: 1936]

[Redacted Unclassified]

COPY

87
Reconstruction Finance Corporation

Honorable Jesse Owens, Chairman

Immediate, please.

In the interest of personal regard I am

writing that the name be furnished to the proper

Union to be upon a mere thought. I will introduce a resolution in the Senate.

If for any reason you fail you cannot furnish the information. 

Any record of any information contained in the above matter

I would ask you, whether or not you have in your letter

later than these facts I would ask you' whether or not you have in your letter

of the fact that statements were made to me that you were shortening time.

An unreasonable that you would have recommended him in the first instance. 

It is inconceivable to me, that if the facts are given to me

* for those who recommended the story for the present position

or those who recommended the story for the present position

* to immediate action or the situation in which you are one

were written in the matter, that is, that you are one

the same made

* the same time required to say that the extent of the plane

which the plane was considered with

either one of relation and the other of incited, and again in some other branches

* the effect that it is, so I say you were introduced in the place in question

When I was in the field recently a report came to me

* by dear Chairman

Washington D.C. May 7, 1939

COPY
Washington, D. C. May 1, 1936.

My dear Jeffy:

In re: Leo T. Crowley

I was recently in St. Paul speaking before a Democratic Convention, as you perhaps know, and heard several very ugly rumors with reference to the above named gentleman, to the effect that he was very heavily involved in some banks at Madison and Milwaukee, Wisconsin, and also some other banks which were taken over by these National Banks.

If the rumors which I heard with reference to his being involved to the extent of from 4½ to 5 million dollars are true, it would account for some of the things which have been going on in the Northwest in permitting some of the banks to control his appointees.

I was informed that this was going to be brought out by the republican organization in the Northwest, and that this money had been made up to the banks by loans from the RFC.

If my informant gives me the correct information with reference to this, it seems as if it was a scandal which would equal the Teapot Dome.

I am taking the liberty of writing to you with reference to this matter, and to ask whether or not you have any information on this subject. I understand that you approved the appointment of Mr. Crowley in the first instance, and I can hardly believe that you would recommend a man for this position if the facts which have been given to me are correct.

I would kindly ask you to give me a report on the matter. If you feel you cannot do so without a resolution, I will introduce in the Senate calling upon you for any information you may have upon the subject.

With kindest personal regards, I am

Sincerely yours,

BKW*M

(Signed) Burton K. Wheeler

Hon. J. F. T. O'Connor,
Comptroller of the Currency
Treasury Department
Washington, D.C., May 1, 1936

My dear Chairman:

When I was in St. Paul recently, a report came to me to the effect that Mr. Leo T. Crowley was involved in two banks in Wisconsin, one at Madison and the other at Milwaukee, and also in some other banks, which these two banks consolidated with.

It was also reported to me that the extent of his being involved in these banks was around five million dollars, that the loans made by the banks to him were upon extremely questionable paper, that in fact they were upon stocks which had not been authorized by the Company, or Secretary of State of Wisconsin.

I was also informed that because of these losses, the banks were forced to borrow from the R.F.C., and that your organization was thoroughly familiar with the situation, but that notwithstanding that fact you were one of those who recommended Mr. Crowley for his present position.

It is inconceivable to me, that if the facts as given to me are correct that you would have recommended him in the first instance. In view of the fact that statements were made to me that you were thoroughly familiar with these facts, I would ask you, whether or not, you have in your files any records, or any information, concerning the above matter.

If for any reason you feel you cannot furnish this information to me upon a mere request, I will introduce a resolution in the Senate, asking that the same be furnished to that body.

With kindest personal regards, I am

Sincerely yours

(Sgd) Burton K. Wheeler.

Honorable Jesse Jones, Chairman

Reconstruction Finance Corporation
May 5th, 1936.

Dear Jeffy:

On March 22nd, 1936, I wrote you the following note:

"Confirming my telephone conversation of today, I am waiting for your report on Mr. Crowley so that I can close out this matter.

"I think that the charges that you originated against Mr. Crowley should be substantiated or withdrawn."

I have not received an acknowledgment or further comment from you on this matter. In view of Senator Wheeler's letter to you of May 1, 1936, of which he sent me a copy, I think this matter should now be disposed of without any further delay on your part.

Sincerely,

[Signature]

Secretary

Hon. J. F. T. O'Conner,
Comptroller of the Currency
My dear Mr. Secretary:

Thanks for your memorandum of May 5th in reference to Mr. Leo T. Crowley in your letter to me on March 22, 1935. You say that you have received no acknowledgment or further communication from me on this matter.

In this you are in error as I told you that I had received a full and complete report made by one of the Examiners of this office on the activities of Mr. Crowley in Wisconsin. I further advised you that I had also told Mr. Crowley that I had this complete report and Mr. Crowley told me that he hoped that I would not present this report to you as it would ruin him and that he desired to resign his office as Chairman of the Federal Deposit Insurance Corporation immediately upon the signing of the Banking Bill of 1935. I suggested to you that in as much as Mr. Crowley was going to resign I could see no need of opening this report and causing him any embarrassment. You felt that this was the proper position to take and since that time the matter has rested.

I attach herewith a memorandum handed to Under Secretary T. J. Coolidge under date of May 4, 1936, together with statements of loans in various banks by Mr. Crowley.

Very cordially yours,

J. F. T. O'CONNOR
Comptroller

Honorable Henry Morgenthau, Jr.
Secretary of the Treasury
Washington, D. C.
May 4, 1936

MEMORANDUM:

With reference to the attached copy of letter and excerpts taken from reports of examinations of the First Wisconsin National Bank of Milwaukee dated April 6, 1934 and of the First National Bank of Madison, Wisconsin, dated April 27, 1934, it will be noted at the time of the examination the First Wisconsin National Bank of Milwaukee held obligations of Mr. Leo T. Crowley and his interests amounting to \$400,295.58. Similar obligations held by the First National Bank of Madison amounted to \$606,501.71.

The plans for recapitalizing the banks have been completed. Most of the loans referred to in the schedule held by the First Wisconsin National Bank were charged off. The bank still carries, according to the last report, the personal loan of Mr. Crowley in the amount of \$8,795 and charged off \$157,000 of the amount previously quoted. The only other loan carried by the above named bank is the balance of the indebtedness of the General Paper and Supply Company and the Crowley Wholesale Grocery Company amounting to \$57,731.

The bank referred to above reduced its common capital by \$5,000,000 for the purpose of assisting in the elimination of losses and increased its capital by selling \$10,000,000 preferred stock to the RFC.

The loans held by the First National Bank of Madison, amounting to \$606,501 have been entirely eliminated. These loans were acquired from the State Bank of Wisconsin at the time it was taken over and its liabilities assumed by the national bank, the national bank being guaranteed against loss by the Wisconsin Bankshares Corporation, which Corporation borrowed approximately \$4,500,000 from the RFC. On February 6, 1935 the Corporation transferred to the undivided profits of the subject bank \$996,347.91 in the final settlement of its guaranty in connection with the State Bank of Wisconsin assets. The items charged out were included and transferred to the Wisconsin Bankshares by way of an asset dividend to stockholders. The capital structure of the First National Bank of Madison was also strengthened by sale of \$500,000 preferred stock to the RFC.
My dear Mr. Secretary:

In response to your letter of yesterday advising me that the Secretary had called you on the telephone and is anxious to have in writing a memorandum outlining the facts in regard to Mr. Crowley, I am transmitting the following:

On or about February 5, 1954, Senator Vandenberg of Michigan called me on the telephone and said that he had information which led him to believe that he should vote against the confirmation of Mr. Leo T. Crowley as Chairman of the Federal Deposit Insurance Corporation. The Senator then sent a letter by messenger making specific requests for information, and in this letter, Senator Vandenberg said that he had had the confirmation of Mr. Crowley temporarily held up pending the receipt of certain information. On February 6, 1954, Senator Vandenberg sent a second letter requesting additional information. Copies of both letters from the Senator are attached to this memorandum.

I talked to Mr. Crowley about this matter and replied to Senator Vandenberg under date of February 7, 1954, copy of which is also attached. At the time I dictated the letter of February 7th, Mr. Crowley was at my desk and assisted me in compiling the information which I gave to the Senator. In order to secure up-to-date information, it was necessary to have an examiner make an investigation in Wisconsin, and at the suggestion of Mr. Crowley, I selected Mr. R.L. Hopkins who was a member of the national bank examining force, but at that time had been loaned to the Federal Deposit Insurance Corporation. Mr. Hopkins made a report to me, copy of which is attached. This report was transmitted to Senator Vandenberg and copy of my letter of transmittal is also attached hereto and copy of Senator Vandenberg's acknowledgement of the same.

A newspaper man recently advised me that Senator LaFollette was in the city a few days ago and had made the statement to a number of people that he would have a resolution introduced in the Senate investigating Mr. Crowley and the facts surrounding his appointment. My first information that Mr. Crowley was being considered for the Chairmanship of the Federal Deposit Insurance Corporation was from the press after the President had sent his name to the Senate. I felt it my duty, in view of the endorsement of the President and the Secretary of the Treasury, to do everything I could in an honorable way to have his appointment confirmed and Mr. Crowley appreciated very much what I did and the embarrassment that I saved him before the committee and also the final statement of Senator Vandenberg to me over the telephone that if I would so express myself, he would withdraw his objections to the nomination. You will note in Senator Vandenberg's letter of February 15, the following paragraph:
"On the basis of these communications, Mr. Crowley's nomination was confirmed last night. I hope he will fully justify the confidence which we all are reposing in him. I feel sure he will make every effort."

When my attention was called to Senator LaFollette's position, I made a further examination of my records as well as the last examination of the bank, which I had not done before this incident and it would appear that the Hopkins report is misleading in the following particulars:

His report shows Mr. Crowley owed the First Wisconsin National Bank of Milwaukee $160,295.58, whereas the National Bank Examiner's report of April 6, 1934, shows that Mr. Crowley owes the bank $274,295.58.

Mr. Hopkins' report states that on December 31, 1933, the net proprietary interest in the General Paper and Supply Company (largely owned by Mr. Crowley) is $435,655, with current assets of $491,259 and current liabilities of $56,632; that included in the current assets, however, is an excessive amount of receivables which should be substantially discounted, but on the other hand, the company owns the entire stock of the Goodall Crowley Oil Company, which shows a net worth of $148,060, with current assets of $192,652 and current liabilities of $5,962. This appears to be somewhat at variance with the National Bank Examiner's report which shows the General Paper Supply Company and the Goodall Crowley Oil Company owed the First Wisconsin National Bank $124,500, the Examiner stating that of the receivables of the General Paper and Supply Company, $534,000 was due largely from the Crowleys and that the receivables of the Goodall Crowley Oil Company, $134,000, are practically all due from the Crowleys.

Mr. Hopkins' report states that Mr. Crowley and his brothers have full operating control of the corporations and he has been advised are making satisfactory progress in operating such corporations.

The Bank Examiner states Mr. Crowley is too badly extended to give any protection to his indebtedness as maker; that $5,500 represents delinquent interest due; that his collateral consists of stock in a closed Madison bank and 458 shares of General Paper Supply Company and Crowley's Wholesale Grocery Company, which is worthless. The Examiner states the indebtedness of Mr. Leo T. Crowley originally represented a reorganization of the Crowley debts on a four-year plan that was unsuccessful and that the obligations were rearranged in March, 1933, to be payable five years later, with interest at 2% per annum.

The Wisconsin Bancshares Corporation has secured a loan from the Reconstruction Finance Corporation in the amount of $4,000,000, which it is understood is to assist in taking care of these losses.
Attached hereto are copies of schedules taken from reports of examination, one from the First National Bank of Madison, Wisconsin, report dated April 27, 1934 and one from the First Wisconsin National Bank, Milwaukee, Wisconsin, dated April 6, 1934. These were the last examinations of these banks made by the Comptroller's Office. However, in the regular course they will be examined again shortly.

Cordially yours,

J.F.T. O'CONNOR,
Comptroller.

Honorable T. J. Coolidge
Under Secretary of the Treasury.
LOANS AND DISCOUNTS:

<table>
<thead>
<tr>
<th>Amount</th>
<th>Slow</th>
<th>Doubtful</th>
<th>Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>$108,500.00</td>
<td>$40,000.00</td>
<td>$8,000.00</td>
<td>$60,500.00</td>
</tr>
</tbody>
</table>

Leo T. Crowley
A.W. Schulkamp
Collateral is a contract dated June 28, 1952 of Young & Co. sold to Wm. H. Hatton by Crowley as Trustee. Original amount 90M has been paid down to 48M. It is claimed by Hatton contract has been paid down to 40M. The lumber, which originally was the basis of the contract, was moved into Hatton's own yards and the greater portion sold or absorbed in the inventory of Hatton & Co. so that it cannot be identified. No supporting data for Wm. H. Hatton signature, but claimed responsible for balance of contract.

$1,500.00 Ind.  
165,735.58
Leo T. Crowley
Badly involved with heavy other bank obligations. Slow portion protected by share in substandard listed and unlisted stocks held for the benefit of this bank and the 1st Nat. Bank of Madison. No evidence of ability to pay. Obligation dated 1933 maturing 1938 @ 2% interest.

124,500.00
General Paper Sply.
and Crowley Wholesale
Grocery Company. Coll. stock
Goodall-Crowley Co. has no val.
This stock is held pro rata with claim of 156,000. held by State Bank of Wis. Quick assets of 166,700.00 against current debts of 50.7M. Debt to subject bank and obligation to State Bank of Madison in amount of 156,000. deferred to 1937. Included in assets are 105,600. entire stock of Goodall-Crowley which is believed worthless and 325,700. due from officers. Sales last year 408,000. with net profits of 2,000. Fixed assets carried at 150M with enc. of 10,000.

This bank has plans approved for reducing its common capital from $10,000,000 to $5,000,000, using the released capital and part of its surplus funds to charge off losses; and increase its capital by selling $10,000,000 preferred stock to the R.F.C.

**LOANS AND DISCOUNTS**

<table>
<thead>
<tr>
<th>Amount</th>
<th>Slow</th>
<th>Doubtful</th>
<th>Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>350,476.38</td>
<td>$20,000.00</td>
<td>$35,000.00</td>
<td>$295,476.38</td>
</tr>
<tr>
<td>Leo. T. Crowley</td>
<td></td>
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<td></td>
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<tr>
<td>Based on participation</td>
<td></td>
<td></td>
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<tr>
<td>sundry stocks together with</td>
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<tr>
<td>guaranty of unknown value</td>
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<tr>
<td>at this time.</td>
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<td></td>
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<tr>
<td>156,025.33</td>
<td>$89,000.00</td>
<td></td>
<td>67,025.33</td>
</tr>
<tr>
<td>General Paper &amp; Supply Co.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Collateral of no credit</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>value. Statement would</td>
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<td></td>
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<tr>
<td>suggest liquidation possible</td>
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<td></td>
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<tr>
<td>as shown.</td>
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<tr>
<td>100,000.00</td>
<td>$50,000.00</td>
<td>10,000.00</td>
<td>40,000.00</td>
</tr>
<tr>
<td>Goodall-Crowley Oil Co.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Statement poor. Payments should develop per schedule of maturity. Liquidation as classified a suggested possibility.</td>
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</table>

The Holding Company affiliate of this bank has a plan approved whereby it will borrow $4,000,000 from the R.F.C. About $1,000,000 of this amount is to be used to eliminate unsatisfactory assets in the bank. The bank itself is selling $500,000 of preferred stock to the R.F.C.
May 5, 1938

I just called McIntyre about the O'Connor-Crowley fight and McINTyre said he was just calling me; that he was very much worried about it; that O'Connor had been over to see him and O'Connor seems worried. I read McINTyre my letter to O'Connor which I sent in to O'Connor this morning. It was news to McINTyre.

I told McINTyre that Vandenburg knows all about this. He said, "I know he does," and he said "Both O'Connor and Crowley have got to explain some of the things that they have done." He then asked me to come to, I gathered, a confidential meetings at 2:30 on Housing and wanted me to stay behind after the meeting and talk to the President about O'Connor and Crowley.
At 5 P.M. on May 5, 1936, the Secretary called Comptroller O'Connor and Mr. McReynolds in his office to discuss the record as to what had happened with respect to certain charges made against Chairman Leo T. Crowley, of the Federal Deposit Insurance Corporation. The Secretary called the Comptroller's attention to his (the Secretary's) letter of May 5, 1936, to the Comptroller, which recited the fact that the Secretary's letter on the same subject addressed to the Comptroller on March 22, 1935, had not been acknowledged or commented upon since its receipt by the Comptroller, and to the following statement in Mr. O'Connor's reply of May 5th as follows:

"In this you are in error as I told you that I had received a full and complete report made by one of the examiners of this office on the activities of Mr. Crowley in Wisconsin. I further advised you that I had also told Mr. Crowley that I had this complete report and Mr. Crowley told me that he hoped that I would not present this report to you as it would ruin him and that he desired to resign his office as Chairman of the Federal Deposit Insurance Corporation immediately upon the signing of the Banking Bill of 1935. I suggested to you that in as much as Mr. Crowley was going to resign I could see no need of opening this report and causing him any embarrassment. You felt that this was the proper position to take and since that time the matter has rested."
The Secretary explained to Mr. O'Connor that his records indicate that it is Mr. O'Connor who is in error. He exhibited to Mr. O'Connor his diary entry of March 12, 1935, which indicates very clearly that Mr. O'Connor's conversation with the Secretary referred to in his (O'Connor's) letter of today actually took place on March 12, 1935. The Secretary also called Mr. O'Connor's attention to the fact that on March 21, 1935, after staff meeting, the Comptroller remained to speak to the Secretary alone and at that time stated that he had received a voluminous report on the Crowley matter and had placed the report in the lower drawer of his desk unopened; that after reflecting on the matter he (the Secretary) came to the conclusion that he was unwilling to assume any share of the responsibility for delaying final disposition of the charges against Mr. Crowley and undertook to discuss the matter further with Comptroller O'Connor the next day March 22, 1935; that he discovered Mr. O'Connor was not in his office and finally located him by telephone in the Federal Reserve Board offices and undertook over the telephone to make clear to Mr. O'Connor that he, Secretary Morgenthau, considered that final disposition of the Crowley case rested on the receipt of a report from Comptroller O'Connor substantiating the charges and that the matter should be closed up promptly one way or the other; and that after concluding the telephone conversation, for fear Comptroller O'Connor did not clearly understand his attitude, he had written the Comptroller his letter of March 22, 1935, stating his position as follows:
"Confirming my telephone conversation of to­day, I am waiting for your report on Mr. Crowley so that I can close out this matter.

"I think that the charges that you originated against Mr. Crowley should be substantiated or withdrawn."

Mr. O'Connor stated that he had no documentary evidence to substantiate his recollection as to discussions with the Secretary on this subject subsequent to March 22, and that he would not further challenge the Secretary's recital of what had transpired, but that he relied upon the Secretary's conversation with him on the same day as justification for assuming that he, the Comptroller, was to do nothing further in the case until after the Secretary's return to Washington a week later. The record of this telephone conversation is attached. The last and significant part of it is as follows:

"H.M. Jr: - and you came to Coolidge and then Coolidge made these analyses -

O'C: That's Right.
H.M. Jr: -and then you said you weren's satisfied -
O'C: That's right.
H.M. Jr: -and you said you'd make additional investigations -
O'C: That's right.
H.M. Jr: Now -
O'C: It's all correct.
H.M. Jr: My position is I'm waiting for you to either clear the
man or to bring charges.

O'C: Well, if - if - if - if the thing - if the thing - if he should fade out, do you think it's necessary to injure anybody?

H.M. Jr: Well, I've just simply got to take the position that I'm waiting for a report from you.

O'C: Well, that's alright, then. If you'll do that until you get back I'll sit down and talk with you about it.

H.M. Jr: All right.

O'C: All right."

The Secretary pointed out the fact that his letter to the Comptroller dated March 22, 1935, was written subsequently to and in confirmation of his understanding of the telephone conversation in question, and that the letter must be accepted as a clear statement of his position, and that on that basis the responsibility for delaying disposition of the charges against Mr. Crowley rested solely with the Comptroller.

The Secretary stated that he felt the Comptroller had improperly and without justification misrepresented to Assistant Secretary Gibbons, Chairman Jesse Jones of the R F C, and Marvin McIntyre and conceivably to others that the withholding of final disposition of the Crowley case was due to the Secretary's disinclination to press the matter, and in that connection had called attention of at least one gentleman named to the fact that Mr. Crowley had employed the Secretary's nephew in his organization at liberal compensation. The Secretary stated that he felt Mr. O'Connor had undertaken to defend his own actions in this matter at Mr. Morgenthau's expense. The Comptroller vehemently disclaimed
any derogatory statements concerning the Secretary to anyone at any
time and stated that he had and would continue to defend and praise
the Secretary's official acts and conduct at all times and under all
circumstances. The Secretary stated that he did not consider that
Mr. O'Connor's actions in this case justified such a statement on his
part. The Secretary told Mr. O'Connor that he was not looking for
advice from anyone as to what action should be taken in this or any
similar case; that what he had originally asked for and was still
seeking was substantiation of the charges made against Mr. Crowley
and if substantial proof were offered of improper actions indicating
unfitness to hold the responsible position now occupied by Mr. Crowley,
he would insist on Mr. Crowley vacating that position, but if on the
other hand no such substantial evidence were forthcoming, he felt
the matter should be disposed of and the cloud lifted from Mr. Crowley.

The Secretary stated that Chairman Jesse Jones had requested
a hearing with the President on this matter and that the President had
fixed 11 o'clock tomorrow, May 6th, to discuss the matter with
Mr. Jones, Mr. McIntyre and Mr. Morgenthau, and had requested that
Mr. O'Connor be present at that conference and produce the report
concerning Mr. Crowley, which the Comptroller had stated he still holds
unopened in his desk. Mr. O'Connor promised to be present at that
conference.

* * *
March 22, 1935.

Dear Jefty:

Confirming my telephone conversation of to-day, I am waiting for your report on Mr. Crowley so that I can close out this matter.

I think that the charges that you originated against Mr. Crowley should be substantiated or withdrawn.

Sincerely,

Mr. J. F. T. O'Connor,
Comptroller of the Currency,
Washington, D. C.
Hello.

Hello.

Jefty?

Yes, sir.

Henry Morgenthau.

Oh yes, how are you?

Are you in the hotel?

No, I'm over here in the Federal Reserve Board.

Oh.

We're having - we started a meeting about 2:30 and we're still in it.

Oh. I wanted to talk to you about the Crowley matter.

Oh yes. Anything happened recently?

No. I've been talking it over. I - I've got Oliphant and Jeffy here, Oliphant and Jeff Coolidge in my room and we've been going over things and I'm going away tomorrow night.

Yes. Going to be away long?

No, for a week.

Oh yes.

- and I - I simply feel that this whole matter is resting on receiving the report from you.

That's right.

- and I - I think we ought to close up the matter one way or the other.

Well - of course, the only danger of holding it is if somebody up there, like our friend from Louisiana or somebody should - if some busy fellows out there should get busy and get him to shoot off and make it embarrassing here. Now,
that's the only chance we're taking, but I'm sure - my best judgment is not to open this thing until you get back. That'd be my best judgment, then let's sit down with it, Henry.

H.M.Jr: Well, I haven't opened it. I feel that - you see you started -

O'C: I know, I know and I'll - I'll open it and go through, but I - I -

H.M.Jr: - and I feel that the responsibility is yours.

O'C: That's right.

H.M.Jr: - and - I mean it so happened that I was down at Sea Island Beach -

O'C: That's right.

H.M.Jr: - and you came to Coolidge and then Coolidge made these analyses -

O'C: That's right.

H.M.Jr: - and then you said you weren't satisfied -

O'C: That's right.

H.M.Jr: - and you said you'd make additional investigations -

O'C: That's right.

H.M.Jr: Now -

O'C: It's all correct.

H.M.Jr: My position is I'm waiting for you to either clear the man or to bring charges

O'C: Well, if - if - if - if the thing - if the thing - if he should fade out, do you think it's necessary to injure anybody?

H.M.Jr: Well, I've just simply got to take the position that I'm waiting for a report from you.

O'C: Well, that's all right, then. If you'll do that until you get back I'll sit down and talk to you about it.

H.M.Jr: All right.

O'C: All right.
May 6th, 1936.

Dear Jeffy:

I have received your letter of May 5th, 1936, in response to mine of the same date concerning the disposition of certain charges made against Chairman Leo T. Crowley of the Federal Deposit Insurance Corporation more than a year ago, in which you state I am in error in my statement that I have received no acknowledgment of my letter of March 23rd, 1935, nor any comments from you on the matter since that date.

I call your attention to the fact that according to my diary, in which I preserve a daily record of my official acts, the conversation, to which you refer in your letter to me, took place on March 12, 1935; that you reported to me after staff meeting on March 21, 1935, that you had received a voluminous report on the Crowley matter and that you had placed it unopened in the bottom drawer of your desk; that I called you on the telephone the next day, March 22, 1935, and told you that I felt the Crowley charges should be disposed of promptly one way or another, and that I was waiting for a report from you substantiating the charges which you had undertaken to investigate further after a previous report on the matter had been analysed by Jeff Coelidge; and that after I had concluded my conversation with you on the telephone, in order to make doubly sure that I had made myself entirely clear, I wrote you the letter of March 23, 1935, stating that I was waiting for your report on Mr. Crowley so that I could close the matter up, since I felt the charges should be substantiated or withdrawn.

In view of the clearness of my records of this matter, I am convinced that your recollection is at fault.

Sincerely,

[Signature]

Secretary

Hon. J. F. T. O'Connor,
Comptroller of the Currency.
Dear Henry,

As I told you yesterday, there are rumors and statements that have come to the White House to the effect that certain individuals who had dealings in the Banking affairs of Mr. Crowley were later employed by Mr. Crowley, and I believe this should also be straightened out while the present investigation is on. If it should appear that any of the following individuals ever received any compensation from the Federal Deposit Insurance Corporation,

Tom Reese
Fred C. Kellogg
R. L. Hopkins
C. L. Pitman
Herman L. Ekern
Attorney Dempsey

the amounts of such compensation should be ascertained, as well as the date of appointment, if any have been appointed by the Corporation, also a statement as to whether or not any of these individuals were formerly employed by Mr. Crowley in Wisconsin in connection with any of his loans, banking activities, making reports or audits for him, or associated with him in any of his enterprises or banks - also if he dealt with any of them in any official capacity in Wisconsin.
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TO Secretary Morgenthau
FROM Mr. Taylor
Subject: Points in the memoranda submitted by the Chinese representatives to which the Secretary's attention is particularly called.

I

"Memorandum on increasing the use of silver"

1. In the second paragraph of Section IV, Page 4, with reference to the minting of the new silver coins in China, there is no indication of the length of time that will be required to prepare the Central Mint for the task of minting sizeable amounts of the new silver coins.

The history of the operation of the Central Mint is one which may justly raise some doubts whether the necessary alterations will be completed quickly.

It would create a favorable impression here, and would at the same time avoid uncertainty as to the time of issue of the new silver coins if the Chinese Government were to have the new coins minted here until such time as their own mint was ready to take over the operations. There would be a double advantage to the Chinese Government in that arrangement: (1) they would expedite the appearance of the new coins and increase their excess reserves; (2) there would be a small saving - if a credit is to be extended requiring silver as collateral - because the silver received in form of old yuan would have to be refined here at their expense. If the old coins were to be minted into new ones, the expense of conversion would be less, and if the silver sent here as collateral was eventually to be withdrawn, the difference in cost of refining old yuan into bars and into coins would be saved.

2. Of the 200 million yuan coins mentioned on Page 4 as the amount the Chinese Government hopes to issue, it is to be noted that 130,000 of such coins are to replace an equivalent amount of yuan paper notes now outstanding (as mentioned on Page 5).

(a) Insofar as new coins were issued in place of paper notes, the cash reserve back of the notes would be freed, and could serve as a basis for new note issues. For every 100 yuan of notes replaced by silver coins, enough silver would be saved to serve as backing for 25 yuan more of note issue.
(b) The statement on Page 4 that China imported from 1922 to 1931, 750,000 ounces of silver is not to be regarded as a basis for a preliminary estimate of the amount of silver coins China may be expected to absorb as money in the future. The situation was different in those years. China was then on the silver standard and the silver kept by people was either in the form of full weight coins, "shoes", or silver bullion and not subsidiary coinage. It is not to be expected that the Chinese public will hoard or accept subsidiary coins as freely as either full weight coins or silver bullion. Moreover, the whole of China in the years 1922 to 1931 is not to be regarded as identical with the area over which the Nanking Government can now enforce circulation of its new coins.

(c) It is to be noted that the 130 million yuan referred to in the top paragraph on Page V is not to be added to the estimate of 200 million already made on Page 4. According to Mr. Chen, the 200 million includes the coins which are to replace the paper yuan now outstanding.

II
"Memorandum on the question of the independence of Chinese currency."

The explanation offered in this memorandum of the alterations in dollar does not necessarily justify the original step of altering the dollar and keeping sterling fixed when the London-New York cross-rate went up above 25.00. However, the statement made at the end of Page 6 that China will make another declaration, reiterating her policy of not fixing the yuan to either sterling or the dollar, may be satisfactory.

Better evidence that China intends to pursue that policy would be supplied by a change in the sterling-yuan (official) rate. Mr. Lochhead reports that on May 4th the sterling-yuan rate was altered one-sixteenth while the dollar rate was kept the same; and on the next day both rates were changed slightly. Mr. Chen is going to cable his Government for confirmation of those reported rates.

III
"Memorandum on increasing the liquidity of the cash reserves against note issue of the Chinese Government banks."

1. It is understood that any shipments of silver to the United States will be on American bottoms, under the same conditions as were made for the earlier purchases of silver from China.
2. If (?) million ounces of silver are to be purchased, the arrangement might include the following conditions:

(a) Purchases to be made at the rate of (?) million ounces a month for the balance of the year, with the understanding that the agreement is cancellable by either Government on the 15th day of any month, cancellation to apply to purchases after the end of the month.

The monthly amounts are not to be cumulative. If the Chinese Government should contract to sell less than (?) million ounces any month, the difference shall not be added to the purchases to be made in subsequent months. The sale is to be understood as completed during the month in which the silver is placed on board ship at Shanghai.

(b) The price to be paid for the silver is to be the price offered by the Treasury on the 15th day of each month, the Chinese Government being free to sell or not, as it seems fit, at the price quoted.

3. If credit is to be offered to the Chinese, it is suggested that the conditions be as follows:

(a) The privilege of a credit to remain during the remainder of this year. If the Chinese wish, they may, a month and a half before expiration, renew negotiations for consideration of an extension.

(b) The interest rate is to be 2 per cent.

The justification of this low rate of interest is:
(1') It constitutes a reward for Chinese endeavor to co-operate in the expansion of the use of silver.
(2') It provides an incentive for other countries to do likewise if they wish to obtain such accommodation.
(3') It provides an adequate return in view of the complete absence of risk involved in the loan.
(4') The U. S. Government pays out less than that for its short-term money, and the transaction is to be regarded in the nature of international monetary co-operation rather than an extension of a commercial loan.

(c) The loan is to be made not against the silver, but against yuan exchange. The silver is to be sent to the United States as further collateral against the loan to the value of 100 per cent of the credit taken up. The silver so sent is to be valued at 40 cents an ounce. This amounts to collateral of 260 per cent when silver is 45 cents an ounce and yuan exchange 30 cents.
I called Mr. Bolton at 10:35 today and reverted to our conversation of yesterday. I told him that, as I had already suggested yesterday, our friends would not feel justified to pay a price for gold abroad which, with shipping charges added, would bring the cost of delivery in New York to above $55 per ounce. I continued that there were several other considerations which made it seem inadvisable to act on his suggestion of yesterday. For us to pay $54.77 in Paris, quite apart from the fact that it would bring the cost up to $55.08 if, subsequently shipment were made to New York, would be equivalent to our selling dollars at 1517 1/2 and that we would then compete with our commercial banks which were now freely taking care of the situation and, at the prevailing dollar rate of 1519, were paying only $54.73 1/2 per ounce. It had always been the Treasury's policy to avoid competition with our own banks. Moreover, we would presumably act contrary to the wishes of the Bank of France, which we understand has suggested to the banks in Paris that they should not ship gold until the dollar went to 1519. Bolton confessed that he had not looked at it from that point of view. I then pointed out that, as mentioned to him yesterday, our order at $54.77 plus brokerage for delivery in London, of course, continued to hold. It did not matter, as far as we are concerned, where the gold came from as long as we did not pay more for delivery in London than our limit of $54.77 plus brokerage. Bolton inquired whether $54.77 represented the net outturn which the gold shipper received in New York and I replied that, according to all our calculations, anybody paying more than $54.77 for delivery in London must be
willing to forego even an interest return on the money invested, leave alone any profit on the transaction.

I thanked Bolton for having put the thought up to us. He replied that his suggestion had been intended as a cooperative effort and that he was glad to have had the opportunity to discuss it with me.

I inquired as to market conditions this morning. Bolton thought things looked a shade better; Paris was obviously much less discouraged today. I asked whether this change was based on anything other than sentiment. He thought it was entirely sentimental; last night everybody had expected an embargo on gold to be declared today, this morning they were happy that this had not happened and had read with satisfaction of Regnier's statement that he was not going to put it on. There was an enormous speculative position in the market, Bolton continued, and the British Fund had "put the market up against them a bit this morning." Their operations were so far on a small scale; he had heard only of a small amount of gold having been engaged for shipment to New York.
Wednesday
May 6, 1936

Operator: Mr. Cochran:

HMjr: Hello -

H. M. Cochran: Hello, Mr. Morgenthau -

HMjr: Good morning - what's the news?

C: Have you received - did you get my wires this morning?
I sent one at ten and one at twelve.

HMjr: Hello - No, I have received no wires.

C: I don't hear you.

HMjr: Have you received any wires from me today?

C: None

HMjr: At eleven o'clock this morning -

C: I sent you that last night at the Cabinet meeting -

HMjr: I - we've got a very bad connection this morning.
Hello?

C: Can you hear me now?

HMjr: Talk very slowly.

C: Yes - Last night -

HMjr: Last night?

Operator: Just a minute, please, Secretary, I'll try to get a
better connection for you.

(Overseas) HMjr: How long will it be?

O.O.: Just a few moments.

HMjr: All right. (Pause)

HMjr: Hello -

C: Hello -
Yes, Cochran -

Can you hear me through?

Much better.

Last night at the Cabinet meeting Sarraut asked his party to remain in office with him until June first.

I see - asked who to remain?

The members of his Cabinet.

I see.

- all of them to remain until June first.

Yes

With the understanding that in the meantime he will keep in touch and consult with the leaders of the new majority.

I see.

And at the close of the meeting Regnier, the Minister of Finance -

Yes

Gave out a statement to the press.

He did what?

Gave a statement to the press, -

Yes, we got that.

So you have that?

Yes

- that just confirmed the information that I had given you before from the Bank of France.

Yes

But this was the first time they had made any public statement -

Yes

- the Government since the election.
HMJr: I see.
C: So that has had a very quieting effect.
HMJr: Yes - well, that's all right. Now, - things seem a little quieter then?
C: It did, yes - up until noon. I talked with Cariguel at twelve o'clock -
HMJr: Yes
C: At that time only a quarter of a billion dollars had been sold.
HMJr: Yes - well, that's very good.
C: Yes
HMJr: Yes
C: At three o'clock I spoke with the Guaranty -
HMJr: Yes
C: I was talking with them when you tried to get me first.
HMJr: Yes
C: At three o'clock they had done a little less than two billion dollars.
HMJr: Yes, I see.
C: But business was increasing just a little at that time.
HMJr: Well then, it looks as though the Cabinet would hang on until June one?
C: It all depends, as I said before, upon this monetary situation.
HMJr: I see.
C: - capital outflow -
HMJr: Yes
C: If this statement succeeds in quieting them - the cabinet quieting the capital fright -
HMJr: Yes
C: Then this Cabinet will positively hold on until June first.
HMjr: I see.
C: They had a special meeting of the Regents of the Bank of France -
HMjr: Yes
C: - at twelve o'clock today.
HMjr: Yes
C: - and raised the bank rate from five to six percent.
HMjr: Yes
C: They had refrained from taking such action -
HMjr: Yes
C: - until Regnier might declare himself.
HMjr: Yes
C: But now that he has given this statement and the situation reacted -
HMjr: Yes
C: - the Bank to do its part, raised the rate.
HMjr: Yes - all right.
C: No - it may be quiet a while now, see?
HMjr: O. K.
C: But I look for it to get nervous again as the first of June approaches. That's fairly possible.
HMjr: Well, that's another life-time.
C: Yes (Laughter) That's plenty of time.
HMjr: All right.
C: Fine
HMjr: O. K.
C: But I'll send you the wireless, you see, if I get something from my friend -
HMjr: Yes
C: Fine
HMjr: Thank you
C: But there are two wires on the way to you now.
HMjr: Well, we'll get them in time.
C: One - in one of them I quoted Parker Willis - in a cable this morning -
HMjr: Yes
C: - The American stabilization fund was very active yesterday.
HMjr: Yes
C: He said that it furnished the Bank of France with great amounts of dollars against the gold - earmarked.
HMjr: Well, Parker Willis is getting old.
C: (Laughter) I think the people here will believe it pretty soon.
HMjr: I hope so.
C: Yes
HMjr: Thank you.
C: All right, sir
HMjr: Goodbye.
MEMORANDUM FOR THE SECRETARY:

As reported to you verbally, conferences were had this morning with representatives of the Seagram Company and Hiram Walker.

Following our conferences on May 4, the State Department (Messrs. Phillips and Hickerson) was advised (informally by Mr. Whitaker and myself) that the negotiations with the Seagram Company had definitely broken down. A copy of my memorandum of May 4 to you was handed to Mr. Phillips, and I advised him of the intention of the Secretary of the Treasury and the Attorney General immediately to request the Chairman of the Senate Finance Committee to proceed with the pending legislation.

Mr. Phillips made the suggestion that it might be advisable before any final action should be determined upon, for the State Department to call in the Canadian Charge and inform him that unless substantial offers should be made immediately by the Canadian companies the legislation would be proceeded with, Mr. Phillips' purpose being to afford the Canadians one final opportunity, should they desire to have it, to make offers in compromise of the Government's claims against them. Mr. Phillips was advised that there would be no objection on the part of the Treasury Department and the Department of Justice to this course of action.

On Tuesday, May 5, the State Department (Mr. Hickerson) advised the Treasury (Mr. Graves) by telephone that, as the result of the representations made to the Canadians by the State Department pursuant to the foregoing, the Seagram Company desired to reopen negotiations for settlement.

Today's conferences with Seagras and Hiram Walker followed, with the results below indicated:

Seagrams.

Mr. Phillips, counsel for the Seagram Company, stated that at his meeting with the Government's conferees on Monday, May 4, he had not
intended to be understood as submitting final offers on behalf of his company; and that he regretted very much that the Government's conferes had so understood him. He said that the Canadian Government was now about to fasten the responsibility for the breakdown of negotiations and for the determination of this Government to proceed with the legislation, upon him and upon his company; and that he did not desire to take such a responsibility. He said that he was, therefore, prepared to enter into further discussions with the Government. He submitted the following offer in settlement of the Government's claim:

The sum of $1,200,000, to be paid in full on or before January 1, 1937, instalment to be paid at the rate of 30 cents per gallon on all spirits imported into the United States by the Seagram Company, any outstanding balance which might exist on January 1, 1937, to be paid in cash on that date.

Mr. Phillips was careful to say that this was not necessarily the final offer of his company, and that in the event this offer should not be acceptable, he desired to proceed further with the negotiations.

On behalf of the Government, Mr. Whitaker advised Mr. Phillips that his offer was not acceptable, and that it would have to be substantially increased before it could be given favorable consideration.

Mr. Phillips was told that the Government's conferes would receive him at any time up to Monday, May 11, for further discussions; and he asked for, and was given, an appointment for 3:30 to-morrow afternoon (May 7).

At this morning's conference, Mr. Phillips again stated that his company did not consider it practicable to make any offer on alternative No. 2 (jurisdiction and security).

Hiram Walker.

Mr. Lash, for Hiram Walker, repeated to the Government's conferes that his company differed with the Government as to both the facts and the law of the Government's case; and that his company was convinced that it was not in fact liable for any part of the amount of the claim which had been asserted. Mr. Whitaker, on behalf of the Government, agreed that these differences of opinion existed, and suggested to Mr. Lash that for this reason it was the Government's preference that the Walker Company should submit itself to the jurisdiction of our courts, so that there might be a judicial determination of the issues which were involved. He stated that but for the earnest desire of both Governments to avoid objectionable legislation this Government would have insisted upon such a judicial determination; and he suggested that in view of the position now taken by the Walker Company, the best thing which could be done in the interest of both parties would be for the company to agree at this
time to submit to the jurisdiction of our courts, and to give security for the payment of any judgment which might be obtained as the result of litigation.

Mr. Lash replied that his company must definitely decline to enter into any such arrangement, but that it was willing to tender an offer in compromise of the claim. He tendered such an offer, as follows:

$800,000, of which $200,000 would be paid in cash, the balance to be paid in instalments at the rate of 20 cents per gallon on all spirits imported into the United States by the Hiram Walker Company until full payment had been made.

Mr. Lash was advised that his offer was unacceptable.

While Mr. Lash did not indicate that his company would desire to make a further offer, it is considered likely that this will be done.

GRAVES.
Dear Henry:

I was rather surprised yesterday when you advised me in your office that I had violated a rule laid down by the President that all bills should be cleared through the Director of the Budget and that I had introduced bills which had not been cleared.

I am enclosing herewith copies of letters received from Honorable Wayne C. Taylor, Under Secretary of the Treasury, one dated April 20th in which Mr. Taylor cleared two of my bills and gave me permission to introduce them, reserving the right of the Treasury later to object, and an undated letter from Mr. Taylor in which he cleared all of the other bills and returned the drafts of the legislation on the same conditions.

I called Mr. Bell, Director of the Budget, and asked him to give me the number of the bill which was introduced by me without the Budget's approval, and he said that several bills were introduced without the Budget's approval. I told him of my conditional clearance from Under Secretary Taylor, and Mr. Bell said that Mr. Taylor, being new, probably was not familiar with the rule. I told Mr. Bell that of course I felt that when I got a clearance from the Secretary's Office, that was as far as I should go.

I am sure you will be glad to correct your records to this extent.

Cordially yours,

J. P. T. O'Connor
Comptroller

Honorable Henry Morgenthau, Jr.
Secretary of the Treasury
Washington, D. C.
My dear Mr. O'Connor:

I am returning the drafts of legislation which you forwarded with your two letters to the Secretary of April 16.

If you wish to submit these drafts to Congress at the present time, I shall not object to your doing so, although I am not now in a position to assure you that either of the proposals can be given the Department's approval.

Very truly yours,

/s/ Wayne C. Taylor
Acting Secretary of the Treasury.

Hon. J. F. T. O'Connor
Comptroller of the Currency
My dear Mr. O'Connor:

I am returning the drafts of legislation which you forwarded with your letter to the Secretary of March 31.

If you wish to submit these drafts to Congress at the present time, I shall not object to your doing so, although I am not now in a position to assure you that all of the proposals can be given the Department's approval.

Very truly yours,

_/s/_ Wayne C. Taylor
Acting Secretary of the Treasury.

Hon. J. F. T. O'Connor
Comptroller of the Currency.
MEMORANDUM RELATIVE TO S. 4513, A BILL TO AMEND THE ACT ENTITLED "AN ACT TO PROVIDE A NATIONAL CURRENCY SECURED BY A PLEDGE OF UNITED STATES BONDS AND TO PROVIDE FOR THE CIRCULATION AND REDEMPTION THEREOF."

This bill provides as follows:

1. The Comptroller of the Currency is given unlimited power to make such rules and regulations as he deems necessary for the performance of duties imposed on him by the provisions of laws relating to national banks.

2. "Notwithstanding any other provision of law, the Comptroller of the Currency, in fixing the salaries of Deputy Comptrollers of the Currency, and of other officers and employees who are now or hereafter may be under his direction by virtue of any provision of law, and whose salaries are payable from funds under his control and supervision derived from assessments levied by him or as otherwise provided by law, may apportion their salaries among said funds where they render services in connection with more than one administrative division or branch of the duties and functions imposed by law upon him in any capacity."

Comments.

The provisions conferring unlimited power to the Comptroller relative to the issuance of regulations and rules warrant careful consideration for the following reasons:

1. The Comptroller of the Currency has not previously been given blanket power to issue regulations incident to the performance of his duties. Previous law has authorized him to issue regulations in the following specific cases:

   a. In the case of a national bank acting as an insurance agent or broker.

   b. For the computation, assessment, and collection of expenses of examination.

   c. In connection with banks in conservatorship under the provisions of Section 211 of the Bank Conservation Act.

   d. In connection with dealing in investment securities by national banks.

   e. For the purpose of defining "investment securities."

   f. Providing for the destruction of obsolete plates and type for national bank notes.
3. If this proposed bill were passed it would tend to give legal effect to regulations previously issued by the Comptroller of the Currency without authority.

4. The position of the Federal Deposit Insurance Corporation, in its attempts, in the interests of efficiency, to persuade the Comptroller to relax certain of his existing rules pertaining to liquidation of closed banks would be considerably weakened.

5. The natural effect of the passage of this bill would be to increase considerably the regulations issued by the Comptroller.

While the provisions relating to the distribution of salaries of officers and employees under the direction of the Comptroller among various divisions or branches ostensibly apply only to officers and employees actually on the rolls of the Office of the Comptroller of the Currency they may, in fact, be much more far reaching than that, if the Comptroller is able to substantiate his claim that agents of the Federal Deposit Insurance Corporation acting for the Corporation in connection with the liquidation of closed banks are, in fact, agents of the Comptroller of the Currency, the salaries of these employees would in all probability be made subject to the provisions of this law. If it is determined that the Federal Deposit Insurance Corporation is an independent contractor having jurisdiction over its own employees or agents rather than an agent of the Comptroller of the Currency in the liquidation of closed national banks, then this law would probably in no way affect employees of the Corporation.

If these provisions relating to the fixing and distribution of salaries actually are intended to apply only to employees on the rolls of the Office of the Comptroller of the Currency, it would appear that this proposed bill is unnecessary, since such a distribution of expenses should be purely an administrative matter and should not require a law similar to the one proposed.

It appears highly desirable that in order to avoid further conflict between this Corporation and the Comptroller of the Currency, and to eliminate the possibility of additional confusion in the matter of liquidation of closed national banks that the proposed law in its present form not be passed.
The Honorable,
The Secretary of the Treasury.

Dear Henry:

The Farm Credit Administration has no convenient garage facilities for its official cars, four of which are kept at Second and Canal Streets and two at Thirteenth Street and Constitution Avenue.

If the building at 406 Thirteenth Street, N. W., which is adjacent to our offices, should become available it would afford very convenient garage facilities, as well as storage space on the upper floors for reserve equipment now stored in Temporary Building F, and for inactive files and miscellaneous supplies now inadequately stored in our office building.

I will very much appreciate your consideration of our needs should the building referred to be vacated.

Sincerely yours,

/s/ W. I. Myers
Governor
Preliminary memorandum on bills recommended by Comptroller of the Currency.

1. S. 4511, To increase examination fees of District of Columbia Credit Unions: The effect of this proposal would be, certainly with respect to small credit unions, to charge fees greater than the credit unions could stand. I am informed by Farm Credit that the actual cost of examination will run from $30 to $50 per examination, an increase of many times over the present average fee of $5.48, and that no credit unions smaller than $15,000 could stand this charge.

2. S. 4513, Authorizing the Comptroller to make rules and regulations and to apportion salaries of his employees: The rules and regulations are not subject to approval by the Secretary and the effect of apportionment of salaries while ostensibly designed to permit the cost of the Chief Deputy to be allocated to closed banks on which he is now working exclusively, would actually be to permit the allocation to going banks of the expense of the entire insolvent bank section, the work of which is probably tapering off and will soon be negligible in view of the winding up of receiverships and the activities of Federal Deposit Insurance Corporation.

3. S. 4515, Referring to conversions of state banks into national banks. This amendment would accomplish two things; first, to permit state banks to become national banks with less than the required amount of prescribed capital where they have outstanding capital notes or debentures given to the Reconstruction Finance Corporation, if they give
assurances satisfactory to the Comptroller that they will increase their capital after charter to the required amount and retire their capital notes or debentures; and, second, to abolish double liability on their shareholders when they have so converted. The success of the first proposal will be dependent largely upon the cooperation of the Reconstruction Finance Corporation and we have not yet been advised of their attitude; and the second suggestion has the disadvantage that it unduly encourages state banks to convert since a state bank organized prior to 1933 could by conversion relieve its shareholders of liability, a course not open to a national bank chartered at the same time.

4. The remaining three bills - S. 4510, S. 4512, and S. 4514 are being revised and we have not yet been furnished with the ultimate revision.
O'Connor's Bank Bills
Opposed By FDIC;
Hearings to Reopen

Long Standing Conflict Renewed on
Comprouller's Jurisdiction in Re­ceiverships

FROM THE WALL STREET JOURNAL Washington Bureau
WASHINGTON—The long standing conflict between the Federal Deposit Insurance Corp. and the office of the Comptroller of the Currency for increased jurisdiction over the nation's banking system Tuesday showed promise of breaking into the open before the end of the week.

A general reopening of this issue which has simmered with intermittent outbursts since the inception of the Deposit Insurance Corp. was pointed to when the House Banking and Currency Committee announced that, at the request of the FDIC, it will reopen hearings on the banking legislation recommended by Comptroller J. F. T. O'Connor.

The banking bill, which would give the comptroller new and increased powers over banks in receivership, was ordered reported to the House last week by the committee. The committee's decision to reconsider the measure is tantamount to a recission of its favorable report on the measure.

Members of the committee said that the FDIC has raised objections to a provision which would give preferential treatment to those shareholders in banks in receivership who have paid up their assessments and permit them at the discretion of the comptroller to select an agent to replace the receiver after all claims have been settled. The FDIC, it was said, feels that unless special provision is made its claims against residual assets might be jeopardized by such treatment.

There is some sentiment in the committee to revise the legislation to give the FDIC power to examine national banks. Under existing laws, the office of the comptroller is the only agency with this power. The FDIC feels that since it insures these banks and carries the risks, it should have a part in determining when failing banks should be closed and should be permitted to make examinations.

The committee plans to reopen the hearings on Wednesday or Thursday. Leo T. Crowley, chairman of the FDIC, and Comptroller of the Currency O'Connor are scheduled to appear.

When the hearings were first held, Mr. O'Connor was the only witness to testify before the committee, with the FDIC being left out completely.
Major Banking Law Changes Not Expected To Be Made by Congress at This Session; O'Connor Offers Committee Five Minor Bills

BY CARLTON SKINNER

WASHINGTON—Statements by the two senators with a large degree of control over banking legislation indicate that no changes will be made in banking laws at this session of Congress.

Senator Carter Glass, (Dem., Va.), chairman of the subcommittee on monetary policy, banking and deposit insurance of the Senate Banking and Currency Committee, declared there is a "decided probability" that no banking bills will be passed by the Senate. Referring critically to his experience in the last few sessions, Glass said, "They no sooner get the ink dry on one bill than they start to write another." He said there were no important bills before his subcommittee nor was there any need for a banking bill this year.

Senator Duncan U. Fletcher, (Dem., Fla.), chairman of the Banking & Currency Committee, said he saw no reason for banking legislation, although he had no objection to passage of five small bills submitted to the committee by Comptroller of the Currency O'Connor.

One bill would permit national banks to declare dividends on common stock at any time instead of on a semi-annual basis as is now required.

Another would require national banks to transfer earnings to surplus every six months, whether or not any dividends are declared, until surplus equals 100% of common capital.

A third would allow the Comptroller of the Currency to treat capital notes and debentures of state banks as preferred and common stocks not subject to double liability in cases in which the state bank is converted into a national one provided an exchange is effected after conversion is completed.

A bill which might induce state banks to enter the national system is one allowing converting state bank to be treated as newly-chartered institutions, with its stock not subject to the double liability.

The final proposal would give preferential treatment to shareholders in closed national banks who have paid stock assessments levied by the comptroller in cases where liabilities exceeded assets.

The five bills did not go through the Treasury channels. A report is still to come from Secretary Morgenthau and there is as yet no indication whether or not it will be favorable. At the only hearing on them to date, Robert V. Fleming, president of the American Bankers Association, recommended minor changes in phrasing, which would make them satisfactory to him.
Leo T. Crowley: Yes

HMjr: I got a message from your office and then I spoke to Jesse Jones about your being over there at eleven.

C: Yes

HMjr: I called up McIntyre and McIntyre said he'd rather that you didn't come but that you hold yourself in readiness at the office, see?

C: Thank you, I'll do that, Mr. Secretary.

HMjr: If you'd stay around your office from eleven until twelve in case we'd want you, but he said he'd rather first sit down with Jones and O'Connor and myself.

C: That's perfectly all right. I want you to keep this in mind, Mr. Secretary, of course, that that gives that fellow a chance to make a lot of accusations that puts me more or less in a position that I have to substantiate everything he says, but I know you understand that.

HMjr: Well, this is the way McIntyre wants it.

C: Sure, I know that.

HMjr: And -

C: I'll be very happy and I'll be at the office - if you want me call me.

HMjr: All right.

C: Thank you.

HMjr: Thank you.
Hello - hello - hello -

Operator: Secretary Morgenthau, Mr. Jones -

HMjr: Put him on, please.

Operator: All right, he's on.

HMjr: Hello

Jesse Jones: Henry?

HMjr: Yes

J: What do you think about meeting in your office?

HMjr: Well, I think McIntyre wants us over there, doesn't he?

J: All right - I just hadn't any choice - I thought maybe -

HMjr: Well, we could - I go in the back way so they don't see me.

J: You go in the back way?

HMjr: Do you know how to do that?

J: What?

HMjr: Do you know the way to go in through the back?

J: No - is that - how do you do that?

HMjr: Well, if you'd come over to my office we'll walk over together.

J: All right. I'll tell you what -

HMjr: And then nobody sees you. You can get to the Cabinet room from the Treasury without anybody knowing it.

J: I see. Then I'll tell you, I'll come to your office - at what time are we leaving?

HMjr: Five minutes of eleven -

J: All right, I'll be over there at five minutes of eleven.

HMjr: And I spoke to McIntyre and he said he distinctly does not want Crowley there.
J: He did not want him?
HMjr: No
J: So - all right.
HMjr: I've had a call in for Crowley. He's stepped out, but I am going to tell Crowley.
J: All right.
HMjr: See?
J: All right.
HMjr: If you'll be here at five minutes of eleven we can walk over and then nobody sees us.
J: All right.
Wednesday
May 6, 1936

HMjr: What's all this telephoning that you are doing about Crowley?

M. J. Fox: Well, I hope I'm not messing anything up.

HMjr: Well, - why are you in it at all?

F: Well, because, I thought if there was anything there that you want to know you'd have an opportunity to go over this statement. You told me once before you had an opportunity to go over the statement.

HMjr: Well, what statement?

F: That statement of the Legislative - between O'Connor and

HMjr: But Tim, why do you interject yourself into this thing?

F: I didn't want to.

HMjr: Well, were you asked to?

F: No - no

HMjr: You were not asked to?

F: No

HMjr: Well then for heaven's sakes use a little sense.

F: All right.

HMjr: I mean, if you weren't asked to, keep out of it.

F: All right, sir.

HMjr: And if Crowley wants to talk to me let him call me.

F: All right.

HMjr: But use a little horse sense will you please?

F: Well, I asked him to call you and he won't do it.

HMjr: Well, all right

F: All right -

HMjr: Use a little horse sense.
F: All right.
HMjr: All right.
Saw the President about the CCC camps. I strongly urged the President not to raise the limit of families with incomes of $500, first, because that would take away his best argument that employment is decreasing in the country and, second, because I was most fearful that he would extend the qualification for what is an unemployed family generally. He promised me he would not do it.

On Hopkins being out of money — I showed him Bell's figures that Hopkins would be short $23,000,000 on July 1 (statements attached herewith).* I suggested that he take 5% of the unobligated funds which would produce a little over $30,000,000. He balked quite hard at this and said, "it might do a great injustice to the CCC camps where they set aside unobligated funds to buy food". I said, "well supposing they have, you will have a leeway of $7,000,000 and you could reallocate some of this money to any agency where you have done them a grave injustice by taking the money away". He said, "that is right". I said, "shall I have Bell draw up the letters" and he said, "yes" so I asked him whether Hopkins, Bell and I could see him after Cabinet and close the whole thing up at that time. He said, "yes".

I did not give him the letter which I had prepared for his signature and which was addressed to me taking off the red tape on the Hopkins obligations because I wanted him to sign it this afternoon simultaneously when he signed the letters to the agencies taking away the 5%.

He said, "tell Bell that I would like him to make a study of all the unobligated funds in the regular departments as they exist to-day in the present fiscal year just as we did in Albany". I also told Bell to make recommendations to the President as to what unobligated funds in the regular department I can cancel.

I again spoke to him about the tremendous importance of his being able to say on July 1st that he had not touched one single cent out of the billion and a half and I have him now completely sold on this idea. He likes it.

I said to the President, "I am being pushed a little bit hard this week" and he said, "so am I because I have had too many conferences and I am just a little tired".

* See diary of May 8th for attachments.
HU, Jr. today had a meeting with Hopkins and Bell.

The Secretary said to Hopkins, "I told you the other day, Harry, that I considered it very important that not one cent of the $1,500,000,000 be obligated or spent before July 1. The President is now completely sold on that. Bell tells me that after you left here, you and he were $25,000,000 apart. I do not want to say that you should spend $25,000,000 less, so in order to get this money for you I gave the President a scheme and he is going to sign a letter to every agency taking 5% away from them of their unobligated funds, which will give you $30,000,000. (The unobligated balances are $915,000,000, 5% of which is $30,000,000.) I want you to give me your word of honor that if we do this, you will not come back to me and say, You must give me part of the $1,500,000,000." Harry said O.K.

HU, Jr. said to Mr. Hopkins, "This is what I do not want -- 50,000 men at work in the last two weeks in June who will be paid out of the $1,500,000,000 after July 1." To which Mr. Hopkins replied, "What you are talking about are the obligations. On June 30, you have obligated the payroll to July 15 so it is into the next fiscal year." Bell said, "You want to run up to June 30 on the 4 billion 8 money, but he cannot go out before July 1 and buy materials. He has to put in his order prior, but the President can say no material has been taken delivery of and no people have worked or have gotten one cent out of the $1,500,000,000 before July 1."

Mr. Hopkins then asked Mr. Bell the following: "Dan, tell me how much money we will get before I make a definite promise to Henry. I am to get the $5,000,000,000 which Dan is holding for me out of the $47,000,000 and the $23,000,000 more which will take me through to June 30? If Dan can promise me that, I am prepared to say that I will not use a penny of the $1,500,000,000."

HU, Jr. then said, "Then we will have no more discussion and this ends it." Hopkins stated to the Secretary, "I will say that this will be done and the unemployed will not suffer. This is my responsibility and not Gill's and I will do it. I agree that none of this money shall be taken out of the $1,500,000,000."
WORKS PROGRESS ADMINISTRATION

<table>
<thead>
<tr>
<th></th>
<th>Unobligated</th>
<th>Unexpended</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balances as of April 20, 1936</td>
<td>$295.1 M</td>
<td>$505.3 M</td>
</tr>
<tr>
<td>In process of transfer</td>
<td>47%</td>
<td>47%</td>
</tr>
<tr>
<td>Available</td>
<td>$342.1 M</td>
<td>$550.3 M</td>
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</table>

Estimated requirements:

<table>
<thead>
<tr>
<th></th>
<th>For obligation</th>
<th>For expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>April 20-30</td>
<td>$55 M</td>
<td>$65 M</td>
</tr>
<tr>
<td>May</td>
<td>160</td>
<td>170</td>
</tr>
<tr>
<td>June</td>
<td>150</td>
<td>160</td>
</tr>
<tr>
<td></td>
<td></td>
<td>365</td>
</tr>
</tbody>
</table>

Short for obligation: $ 23.1 M

Available for expenditure June 30: $155.3 M
### UNOBLIGATED AND UNEXPENDED BALANCES OF $4,880 M, EXCLUDING WORKS PROGRESS ADMINISTRATION, AS OF APRIL 20, 1936

<table>
<thead>
<tr>
<th>Unobligated balances</th>
<th>5%</th>
<th>4%</th>
<th>3%</th>
<th>2%</th>
</tr>
</thead>
<tbody>
<tr>
<td>$615.7M</td>
<td>$30.8</td>
<td>$24.6</td>
<td>$18.5</td>
<td>$12.3</td>
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<tr>
<td>Unexpended balances</td>
<td>1,379.5</td>
<td>69.0</td>
<td>55.2</td>
<td>41.4</td>
</tr>
</tbody>
</table>
In example city Sewers - R. R. A. many revisions from Jones also loans from sale of securities by Jones.
CONFIDENTIAL

May 7 1936

My dear Mr. Secretary:

Pending the availability of additional funds, to be provided by the appropriation now before the Congress, to carry on the Works Progress Administration program it is necessary to obtain a substantial amount from funds previously allocated from the appropriation contained in the Emergency Relief Appropriation Act of 1935.

It is requested that you immediately make available for re-transfer to said appropriation an amount equal to 5% of the aggregate of the unobligated balances, as of April 30, 1936, of all allocations heretofore made from said appropriation for work coming under your jurisdiction, including funds allocated for administrative expenses.

Please advise me in detail not later than May 11, 1936, the amount which will be available for this purpose. Your reply should indicate the exact amount to be taken from each project, designated by the official project number assigned in the letter making the original allocation, and should contain the statement that the amount under each project is unobligated and unencumbered, and available for transfer back to the original account.

Sincerely yours,

(Signed) Franklin D. Roosevelt.

The Honorable,

The Secretary of the Treasury.

The above letter was also sent to the following:

Secretary of Agriculture
" " Commerce
" " Interior
Attorney General
Secretary of Labor
Secretary of the Navy
Secretary of War
Chairman, Alley Dwelling Auth. for D.C.
Chairman, U.S. Employees' Compensation
Comptroller General of the U.S.
Director, Emergency Conservation Work
Administrator, Federal Emergency Ad. of P.W.

(Antg.) Executive Director, National Emergency Council
Chairman, National Resources Committee
Chairman, Prison Industries Reorganization Administration
Administrator, Resettlement Administration
Administrator, Rural Electrification Administration
Administrator of Veterans Affairs, Veterans Admin.
Office of
The Secretary

May 8, 1935

TOP SECRET

To Heads of Bureaus and Offices Having Allotments
Under The Emergency Appropriation Act of 1935.

The President under date of May 7, 1935 requested that the
Secretary of the Treasury make available for retransfer to the
appropriation contained in the Emergency Relief Appropriation Act
of 1935, an amount equal to five per cent of the aggregate of the
unobligated balances as of April 30, 1935 of all allocations here-
tofore made from the said appropriation for work coming under his
jurisdiction, including funds allocated for administrative expense,
to carry on the Works Progress Administration program pending the
availability of additional funds to be provided by the approipa-
tion now before the Congress.

You are requested to advise the Budget Office not later than
May 8, 1935, the amount which will be available for this purpose
from the allotment made to your office from the above mentioned
appropriation. Your reply should indicate the exact amount to be
taken from each project designated by the official project number
assigned in the letter making the original allocation, and should
contain the statement that the amount under each project is un-
obligated and unencumbered, and available for transfer back to the
original account.

By direction of the Secretary:

Very truly yours,

Geo. H. Reynolds,
Administrative Assistant
to the Secretary.
May 7, 1936

HM, Jr. talked to the President at 9:15 and said, "I have been unable to get Paris. Things look a little bit quieter. The Bank of France put their discount rate up to 6%, which is the orthodox defense of the gold standard. Sterling is a little bit steadier. It is 4.96."

He reported to the President that the Federal Reserve Bank of New York had turned over to the Treasury a copy of cable which the Bankers Trust Company of New York had furnished to the Federal Reserve. This cable came from the London office of the Bankers Trust and asked whether gold could be shipped from the United States to Great Britain by new regulations of the Secretary of the Treasury or whether further legislation would be necessary to permit such shipments. The Treasury opinion, he told the President, is that regulations could be promulgated without further legislation, but, he added, "This is very significant."

He also reported to the President that the Federal Reserve Bank of New York had received a call direct from the Bank of England in connection with our standing order with them to buy gold at $34.77 an ounce, whether we would be interested -- in order to divert some of the present flow from Europe to New York -- in having the Bank of England buy gold for United States account in Paris at $34.77 plus cost of shipment from Paris to London, or a total of $34.80 an ounce, this gold to be held in London for U.S. Account. HM, Jr. told the President that our answer was "Our price is $34.77 and we do not care whose gold it is. If we paid $34.80 it would cost us over $35.00 delivered in New York." (Report of Mr. Knoke, of the Federal Reserve, covering the telephone conversation with the Bank of England is filed under date of May 5.)

HM, Jr. said to the President, "In one day, we had those two feelers. In other words, they are looking which way to turn in case France goes off gold."

The President then said to HM, Jr.: "On that 1933 London Economic Conference file, I have gone over it and I have decided that I should not let these files out of my hands. I, therefore, suggest that you come over sometime and read it here." HM, Jr. replied, "I now have a confidential file that Woodin handed to Bell when he left here which is full of information in regard to Warburg and Douglas."
HM, Jr. asked the President to give him an appointment tomorrow morning. "I would like you to give me a final yes or no on the amount of Chinese silver that we are going to buy," he told the President.

HM, Jr. also told the President that he saw Harry Hopkins yesterday and "if we took off all the red tape he is short $80,000,000. He would need $80,000,000 more to go to July 1. He would have to take $80,000,000 out of the $1,500,000,000. Harry has come down to being short only $25,000,000 and he is coming back again tomorrow. Before we agree to take off the limitations, he will have to say that he has enough money out of the $4,800,000,000 to last him until July 1."
COPY

CABLE RECEIVED FROM BANKERS TRUST COMPANY, LONDON

London, England,
May 5, 1938

COULD BANK OF ENGLAND BE INCLUDED FOR GOLD SHIPMENTS FROM AMERICA BY SECRETARY TREASURY REGULATION OR IS AMENDING LEGISLATION NECESSARY?
May 7, 1936

The Mexican Ambassador, Mr. Najera, came in today to discuss with HM, Jr. the proposal of the Mexican Secretary of the Treasury, Mr. Suarez, transmitted to Secretary Morgenthau in Mr. Najera's letter of April 30. Mr. Suarez' memorandum and Mr. Najera's letter are attached. Taylor and Lochhead were present.

The following conversation took place:

HM, Jr.: Mr. Ambassador, I got your letter from our good friend, Mr. Suarez, and I have been a little slow this time, for two reasons. The last time we talked and we entered into this agreement, which so far has worked very nicely, I kept bringing to Mr. Suarez' attention that I thought Mexico, as the biggest producer of silver in the world, should do something for silver inside of Mexico. Up to today, nothing has happened.

Ambassador: He wants to do.

HM, Jr.: He wants to do if we do something more. But I sort of feel that on the agreement which we made -- the first agreement -- that that ought to have been enough help; that he should have shown some move on the part of the Government that they were going to do something to use more silver in Mexico. Up to date, nothing has happened and I think before we go into another conference it might be nice if the Mexican Government showed that besides selling silver, they were interested in using it.

Ambassador: He is going to put in circulation now more quantity.

HM, Jr.: He spoke of that the last time he was here; that he would take it under advisement, and I brought it to his attention that they might again coin some new silver pesos on a new basis and, as I understood, they still have 100,000,000 old pesos out of which the people did not want to give up in place of money and that they might be exchanged for new pesos. I think they don't need help from anybody.

Ambassador: These old pesos are in circulation in Yucatan; not possible to exchange them.

HM, Jr.: I have not looked it up recently, but you had
200,000,000 paper pesos in circulation and we kept taking and taking, and all I can do is to suggest, but it would be nice if the biggest producer -- Mexico, would show the world that they had some use for silver because they keep telling me that Mexico has paper money and Mexico does not use silver and why should anyone else?

Ambassador: I think it is possible to do that.

HM.Jr.: But I would like them to show a little interest; help me to carry the burden of the world silver.

Ambassador: Well, I will talk to him.

HM.Jr.: Suppose you have a talk with him and say I am a little disappointed because I think it would be a great mistake if he came here and then it was a failure.

Ambassador: Yes. I was talking with him day before yesterday and he said that he is supposed to come about last ten days of this month, if it is possible to do something.

HM.Jr.: Why don't you tell him of this conversation?

Ambassador: I want to do that.

HM.Jr.: Tell him I am a little disappointed.

Ambassador: All right.

HM.Jr.: I had hoped that something would have been done before this.

Ambassador: What do you suggest? I think he will ask for further suggestions.

HM.Jr.: I don't know what to suggest. I just left it this way when he was here, that the Mexican Government should show sufficient interest in silver that they should increase the use of it internally. How they should do it, I did not want to suggest to them.

Ambassador: I see. He wants to do, but he can't.

HM.Jr.: I can't make him do it. I don't want to go
so far as suggest.

Ambassador: I want to talk with him and I will tell him what is your opinion and that if he can find something to -- then if not, this is not the opportunity for him to come now.

HM, Jr.: Not unless he can give me some indication, because he has had three or four months to think this thing over and nothing has happened. You remember, we brought it up and made them a loan on 11,000,000 ounces, but let Mexico show a little interest.

Ambassador: I don't know what the situation is down there.

HM, Jr.: But it would be much better for us to have these preliminary conferences than to have him come here and the newspapers would ask you and ask me to say what happened and we would say, Nothing has happened. The friendship between the two countries is at stake and it's too big a risk to take to have him come up until we know more what he can do. I don't want to take that responsibility, because when he left everything was fine. Everything is fine now. And he comes up and he has certain ideas and we can't meet them and then it would be unfortunate.

Ambassador: I am going to talk to him right away and see what, after this conversation, he is going to do.

HM, Jr.: Yes; see what he can do.

Ambassador: He is anxious to do something, but I think he cannot.

HM, Jr.: Then, if you will give me a ring, I will be delighted to see you again.

Ambassador: All right. After I talk to him, I will see you.
Washington, D. C.,
April 30, 1936.

Hon. Henry Morgenthau, Jr.,
Secretary of the Treasury,
Washington, D. C.

My dear Mr. Secretary:

I take pleasure in sending you herewith a memorandum, written in Spanish, which your colleague and friend, Secretary of the Treasury Suarez, has asked me to bring to your personal and friendly attention.

I take the liberty of enclosing a translation of said memorandum, made by this Embassy; but you may, of course, have your staff make another translation of same document, for greater accuracy.

It is useless to say here that Secretary Suarez, speaking in behalf of my government, concedes to this matter an unusual importance.

Secretary Suarez wants me to tell you, furthermore, that in case you be interested in this proposition, he himself, or the Director of the Banco de Mexico, would be glad to come to Washington, in order to make any final arrangements.

Thanking you, once more, for the friendly interest with which you have followed, since the beginning, the development of this matter; and thanking you also for the attention you might give to this particular proposition, I remain, my dear Mr. Secretary,

Very cordially yours,

Francisco Castillo Nájera,
Ambassador.
MEMORANDUM

1) As a result of high silver prices in the world markets recorded a year ago, the Mexican Government had to retire by law the silver currency then in circulation, to replace it with other coins that would not be subject to the danger of being melted and exported by private individuals.

2) Such measure, obviously a necessary one, meant the demonetization of appreciable quantities of silver and their incorporation into the reserve that the country has to regulate foreign exchange.

3) These two steps have resulted in evident difficulties, which the Government of Mexico should like to eliminate by reorganizing on a better basis both the monetary system and the Institution acting as the Central Bank of the Nation. In this manner it would be possible to give to silver its monetary use, in harmony with the practices that are being accepted as the only ones compatible with the requirements of a Central Bank capable of exercising its functions as to exchange and a well proportioned and adaptable circulation.

4) For this purpose, the Mexican Government plans:

a) To mint again One Peso silver coins to take the place of present One Peso certificates;
b) To issue Five Peso silver certificates that would replace present Five Peso notes. These new bills would represent coined or bullion silver deposited at the Bank of Mexico, and the issue of paper currency in denominations under ten pesos would be forbidden;

c) To substitute present 50¢ coins containing 3.3488 grammes of pure silver (0.420), by new ones with a higher silver contents; and

d) To allow coined or bullion silver to form part of the Reserve of the Central Bank. The latter would be authorized to acquire silver up to 25% of its gold and foreign currency in stock, plus fifteen million Pesos additional.

5) So that the new silver coins and the silver backing the certificates may be protected from another appreciable rise in the price of the metal, the monetary relation selected for the minting of the coins and the issuance of the certificates would be that of eight grammes of pure silver per Peso, Mexican currency. This would bring the "silver melting point" up to a level commensurate with silver prices higher than $1.07 U.S.Cy. an ounce, as long as the present rate of dollar exchange is maintained for the Mexican Peso.
6) Adoption of the above plan would enable the Mexican Government to turn back in a short time to its former monetary use some fifty-eight million ounces of silver, which is all circulation itself could absorb for the time being, for that means currency amounting to approximately 235 millions of Pesos in 50¢ and One Peso coins and Five Peso certificates. Furthermore, after completion of the silver sale transaction outlined below, the plan would make it possible for the Bank of Mexico to include about 35 million ounces in its Reserve.

7) The very nature of the above measures and of those to perfect the plan, demands a more solid Reserve, i.e., a readjustment of present proportions between gold and foreign currency on the one hand, and coined or bullion silver in such Reserve on the other; that readjustment to be made by selling the silver surplus. Besides, unless this last step is taken, the Bank would find it difficult to attempt to retire old silver coins that are still in circulation, for remonetization thereafter.

8) These are the reasons for the Government of Mexico to propose to sell some 60 million ounces of silver, in such a way as not to hurt either the market or present agreements and measures to regulate and support it. On the other hand, it is the belief of
the Government of Mexico that the reorganization of its monetary system, as per the ideas outlined above, will not fail to result in influencing favorably the possibilities of stabilization of that market and even its recovery, partially at least.

9) The Balance of Payments of Mexico often is highly unfavorable, particularly in times of depression, due to the nature and sources of its trade as well as to its position as a debtor nation. This makes imperative the necessity of a solid Reserve, so constituted that without any appreciable loss the Central Bank may at all times dispose of important amounts out of the resources of said Reserve. To attain this purpose, and in view of present silver market conditions, purchases of the metal by the Bank of Mexico would have to be limited to the minimum, unless the Bank were to have a special fund in order to absorb the losses caused by the adjustment of its Reserve to legal proportions between its gold resources and its silver stock, should a heavy drainage occur.

10) The above explains why in order to carry out this plan it is necessary to sell the silver surplus at a price that would furnish the Mexican Government with the means to establish the special fund in question. The Government of Mexico looks forward to
securing a price considerably higher than those prevailing today in the international markets, both, due to the above, as well as in view of the improvement bound to result from these measures for the conditions of said markets.

ΣΑ.
1. Debido a los altos precios que alcanzó la plata hace un año en el mercado mundial, el Gobierno de México tuvo que decretar el retiro de las monedas de ese metal que se encontraban en circulación, para substituirlas por otras que no estuvieran expuestas al peligro de ser fundidas y exportadas por los particulares.

2. Dicha medición, necesaria a todas luces, se tradujo en la desmonetización de importantes cantidades de plata y en su incorporación a la Reserva de que el país dispone para regular sus cambios sobre el exterior.

3. Ambas consecuencias presentan inconvenientes obvios, que el Gobierno de México desearía remover, reorganizando, sobre mejores bases, el sistema monetario y la institución que funge como Banco Central de la Nación, para dar cabida a la utilización monetaria de la plata conforme a las prácticas que tienden a ser consideradas como las únicas compatibles con las exigencias de un Banco Central capacitado para atender su función cambiaria, y de una circulación bien proporcionada y elástica.

4. Al efecto, el Gobierno de México proyecta: (1) la reacuñación de monedas de un peso, en substitución de los actuales billetes de esa misma denominación; (2) la emisión de certificados-plata con valor de cinco pesos, que vendrían a reemplazar a los billetes de igual importe y que representarían plata amonedada o en barras depositada en el Banco de México, quedando prohibida la emisión de billetes con denominación menor de diez pesos; (3) la sustitución de las monedas de cincuenta centavos con contenido de grs. 3.3488 de plata pura y ley de 0.420, por piezas de ley más fina y mayor contenido de plata; y (4) la admisión de plata amonedada o en barras como parte de la Reserva Cambiaria del Banco Central, el que quedaría autorizado para adquirir plata por valor hasta de un veinticinco por ciento del de sus existencias en oro y divisas reunidas, libres de gravámenes, y quince millones de pesos más.

5. Para que las nuevas piezas de plata y la plata representada por certificados queden a cubierto de otra alza fuerte en el precio de ese metal, la relación monetaria escogida para la acuñación de las primeras y la emisión de los segundos es de ocho gramos de plata pura por cada peso, moneda
moneda nacional, lo que elevaría el "melting silver point" al nivel correspondiente a precios superiores a Dla. 1.07 la onza troy de fino, mientras se mantenga el tipo de cambio actual del peso, moneda de México, respecto del dólar moneda americana.

6.- La adopción del plan expuesto permitiría al Gobierno de México devolver en poco tiempo su uso monetario anterior a unas Oz. 58,000,000 de plata, que es todo lo que por ahora podría absorber la circulación propiamente dicha, pues representa signos de cambio por valor de unos $ 225,000,000, en las especies correspondientes, a sea en monedas de cincuenta centavos y un peso y en certificados de cinco pesos. Además, con el complemento de la operación de venta de plata que después se menciona, dicho plan pondría al Banco de México en condiciones de incluir en su Reserva Cambiaria alrededor de Oz. 35,000,000.

7.- La índole misma de las medidas anteriores y de las destinadas a completarlas exige una más sólida Reserva Cambiaria, o lo que es igual un reajuste de las proporciones que actualmente guardan entre sí el oro y las divisas libres de gravámenes, por una parte, y por otra la plata monedada o en barras pertenecientes a dicha Reserva, mediante la venta de la plata sobrante. Sin esta última medida, además, resultaría inconveniente para el Banco intentar el retiro, para su ulterior remonetización, de las piezas antiguas de plata que todavía se encuentran en circulación.

8.- Esas son las razones por las cuales el Gobierno de México pretende vender unas Oz. 80,000,000 de plata, en formas que lesionen lo menos posible la situación del mercado respectivo y los arreglos y medidas destinados a regularlo y sostenerlo. Creo por otra parte dicho Gobierno que la reorganización del sistema monetario de México, conforme a las ideas arriba consignadas, no dejará de producir una influencia benéfica en las perspectivas de estabilización, y aún de recuperación por lo menos parcial, de ese mercado.

9.- La Balanza de Pagos de México suele arrojar fuertes saldos desfavorables, sobre todo en épocas de crisis, debido tanto a la índole y dirección de su comercio como a su posición como país deudor. Eso impone la necesidad de una sólida Reserva Cambiaria y obliga a constituirla de modo que en todo tiempo pueda el Banco Central realizar sin pérdida apreciable una parte importante de los recursos de dicha Reserva. Para conseguir este último resultado, y da en la situación actual del mercado de la plata, sería indispensable limitar mucho las compras de ese metal por el Banco de México, a menos que el mismo dispusiera de un fondo destinado
destinado a absorber las pérdidas ocasionadas por el ajuste de su Reserva Cambiaria a las proporciones establecidas por la ley entre sus recursos en oro y sus existencias en plata, en el caso de un fuerte drenaje cambiario.

10.- El anterior es el motivo por el cual la aplicación del plan expuesto arriba exige la venta de la plata sobrante a un precio capaz de proporcionar al Gobierno de México los medios necesarios para constituir dicho fondo de previsión, y tal Gobierno espera obtener un precio sensiblemente superior a los que hoy prevalecen en el mercado internacional, tanto en esa virtud como en consideración a la mejoría que no pueden menos de producir en las condiciones de dicho mercado las medidas previstas en aquel plan.

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Shortly after 5 P.M. the Secretary and Mr. Upham joined a conference in the office of Senator Harrison, Room 217, Senate Office Building. Others present were Senator Harrison, L.H. Parker, Chief of Staff of the Joint Committee on Internal Revenue taxation, Guy T. Helvering, Commissioner of Internal Revenue, Herman Oliphant, General Counsel and George C. Haas, Director of Research and Statistics.

Senator Harrison explained that the last few days of the public hearings on the Revenue Act of 1936, closed today, had produced effective testimony against the House Bill and that many members of the committee were insisting upon definite modification of the proposed tax on undistributed earnings of corporations. He feared that it would be next to impossible to get the House Bill through the Senate Finance Committee. He expressed a wish to keep control of the situation in his own hands and in the hands of the Administration by being prepared to offer an acceptable compromise rather than losing control of the situation to others of the committee through uncompromising insistence on the House Bill. He was of the opinion that it might be profitable to investigate the possibilities of keeping a flat rate tax on corporation income as at present, thus assuring the collection of a substantial amount of revenue and superimposing upon it a graduated or flat tax on undistributed earnings. The figures he used were a 15% flat tax and a 15% super tax. Senator Connally is proposing a 12 1/2% flat tax and a 12 1/2% super tax. Others have an idea of a graduated super tax on undistributed earnings.

Senator Harrison is of the opinion that such a plan would keep the principle of the President's proposal without running the risks
to the revenue and to the corporations which are involved in the
House Bill.

Commissioner Helvering seemed willing to give consideration
to the compromise bill.

Mr. Parker was of the opinion that there was some advantages
to taking the President's proposal for a tax on undistributed
earnings on corporations in "two bites", and expressed the viewpoint
that there are a great many uncertainties about the present bill
which must remain uncertainties and cannot be definitely forecast.

Mr. Haas agreed that the compromise proposal would produce
revenue.

Mr. Oliphant argued against abandoning the tax on undistributed
earnings and reiterated his position that the area of taxation which
should be exploited is the income of corporations which are owned
by persons who would have to pay a personal income tax in the high
bracket on such corporate earnings if they were distributed. He
referred to the present holding companies and incorporated pocket-
books and to the fact that the Pecora investigation and others had
brought to the notice of the country that a great many exceedingly
rich men paid no income tax and give no support to the Government.
As he put it, the pending bill does not increase taxes; it stops
tax avoidance. Many of the small taxpayers will pay less taxes and
many corporations will pay less taxes or nothing at all.

Mr. Oliphant also referred to the propaganda which plays up a
large percentage of tax under the House bill to the retained portion
of earnings. He demonstrated that even greater percentages of tax
to retained earnings exist under the present law.

Mr. Oliphant was further of the opinion that the President and
the party are now so committed to a tax on tax avoiders through a forced distribution of corporation earnings that to abandon it at this stage would give political opponents an opportunity to denounce and ridicule the President for having abandoned a major principle of merit.

Senator Harrison said that he was not worried about the political aspect of that and remarked that he could use on the floor of the Senate, in support of the modified plan, the identical arguments used by the President in favor of the proposal embodied in the House Bill.

Mr. Morgenthau excused himself from the conference after half an hour stating that he was too exhausted physically to be able to contribute much to the discussion, but expressing his readiness to discuss the matter further at a later time and accompany Senator Harrison to the White House for a decision. (Mr. Morgenthau later stated to the Treasury group that he had been unwilling to indicate by "even the flicker of an eye lash" his reaction to the Harrison suggestion prior to further discussion with the Treasury group and with the White House. It was for that reason that he preferred to postpone his discussion of the matter until later).

The rest of the group continued the discussion for some time.

Senator Harrison expressed doubts about the amounts that would be collected under the windfall tax.

Senator Harrison said that Secretary Wallace would appear before the Committee on Monday.

Senator Harrison asked for Treasury estimates on revisions of the House Bill. He suggested that the testimony of certain witnesses, particularly Mr. Ballantine, Mr. Sargent and Mr. May be reviewed by the Treasury for the presentation of answering arguments in the Executive Sessions of the Committee which begin on Monday, May 11th.
May 7, 1935

My dear Senator:

Yesterday, part of the statement which I made before your Committee on April 30 was challenged. The particular part of the state-
ment was the following:

"The Department has also esti-
mated 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 distrib-
uted to the individual owners of the stock represented in these cor-
porations, the resultant yield in additional individual income taxes would be about one billion three hundred millions."

I can see that the phrase "withheld from stockholders" was possibly open to misunderstanding inasmuch as the figure $1,500,000,000 was arrived at after we had deducted from the $4,500,000,000 an amount equal to the existing corporation taxes.

What I have just said about a possible ambiguity in the use of this term relates to one of my argu-
ments on the merits of the proposed corporate tax, not at all to my statement of the Treasury's estimate of what this tax would yield. That estimate is 623 million dollars additional revenue.

Sincerely yours,

Secretary of the Treasury.

Honorable Pat Harrison,
Chairman, Senate Finance Committee.
My dear Senator:

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"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."

The statement "withheld from stockholders" I can see was possibly open to misunderstanding inasmuch as the figure $1,300,000,000 was arrived at after we had deducted from the $4,500,000,000 the present corporation income tax which amounts to $1,100,000,000.

I believe that this will clear up any possible misunderstanding as to the use of the term "withheld from stockholders."

Sincerely yours,
What I have just said about a possible ambiguity in the term I used in my statement to your Committee relates to only one of my arguments on the merits of the proposed corporate tax, not at all to my statement of the Treasury's estimate of what this tax would yield. That estimate is 623 million dollars additional revenue.
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The statement "will be withheld from stockholders" I can see was possibly open to misunderstanding inasmuch as the figure $1,300,000,000 was arrived at after we had deducted from the $4,500,000,000 the present corporation income tax which amounts to $1,100,000,000.

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May 7, 1936

PRESS CONFERENCE

Q. Mr. Secretary, there are reports that the Treasury plans to utilize the silver profits for payment of some of this bonus. Wall Street is talking about it.

A. They are always right! No; you will just have to charge that off to another Wall Street rumor, I guess. Nothing in it.

Q. Does it look like you are going to get the job done by the scheduled date?

A. Yes, I am quite sure everything will go out on time. I have seen the figures on what the lag is and each week we are getting nearer and nearer up to date with the number of names which are furnished us by General Hines.

Q. Will you make any comment on Mr. May's charge that the Treasury has underestimated?

A. There is a letter in preparation which I am sending up to Senator Harrison today and it ought to be up there by noon and Senator Harrison said he would give it out up there.

Q. Off the record, can you give us a general idea, without using it until he gets it out?

A. I think, off the record, he did not read all of Mr. Helvering's statement. He took the part which he liked best.

Q. That's in reference to the $4,500,000,000?

A. Yes. And my figures on the revenue and Mr. Helvering's check. There is no difference.

Q. How about the underestimates, without regard to whether or not there are misstatements?

A. We don't do that. All we have ever done is, when we estimate our revenue we estimate very closely on the conservative side. Our figures over the last two years
prove that our estimates have been as near correct as any human being can make them and — this is all off the record — I have never faked any figures since I have been here and you boys know that I am not going to fake them to get a tax bill or anything else.

Q. On this recovery. That was not counted in.

A. No, we took in recovery. They think we have not allowed for business recovery, but we have, absolutely, and our estimates have been within one percent of being right. Let's be practical -- when we made this estimate, last December or last November, no one could guess that Congress would throw this thing out and no one knew we would have the bonus and I sat back and looked into the crystal and knew they would be thrown out. We have to go on the assumption that we faked them when we made them up last December, which is perfectly cock-eyed. The figures are just as correct as anybody could make them. After all, the one thing here is we have to keep the confidence of the public and when the Treasury says something they mean what they say and in order to get a tax bill or anything else I would not fake any figures. We can make honest mistakes. We all make mistakes. Certainly Mr. Mills had to go back on the Hill three times to correct his figures. I have no doubt his mistakes were honest ones, but he had to go back three times, and Mr. Mellon, I think, undershot the mark one year; was off 50%. I am not saying he did it for political reasons. I am saying somebody made a mistake. We have been lucky and our figures are extremely accurate, but don't forget they were made last December.

Q. Does it still stand that the Treasury feels the tax bill will raise more money than existing law?

A. It still stands. Still off the record -- you will get the letter. If Mr. May had read all of Mr. Helvering's statement through, he would have seen that his statement and mine jibe.

Q. Do you still expect this year's deficit to be $5,766,000,000?

A. Nothing has been brought to my attention, in or out of the Treasury to make me change that figure.

Q. That letter isn't up there yet?
A. No, it is not finished and it will be 12 or 1 o'clock before it goes up there.

Q. Would it not be necessary to increase the rate of expenditure -- that is, leaving the bonus out of consideration entirely -- to almost double the rate of other monthly expenditures to reach such a deficit figure?

A. I have not any notes here, but as I explained to Bob, the other day, the difference between these estimates is -- the bonus goes on the books of the Treasury as a charge. It does not mean all 2,300,000,000 are going to be cashed, but once they leave our possession they become a charge ... 

Q. But I mean other expenditures. General and recovery expenditures at the present monthly rate, if continued during the next two months, would make for a deficit considerably smaller, would it not, than your estimates of last week?

A. Not according to the people in the Treasury who are responsible for those figures and who have been following them every day. These men have been here since I have been here. I have never once given out any fake figures in the Treasury to try to influence any legislation or political situation. I have not done it once and the men who have been here know it is so. I have never intentionally given out any wrong figures. In the first place, it would be most stupid thing I could do and, without trying to make a stump speech, the reason the bond market has gone up and our credit has gone up is that when I make a statement on figures people who put their money in Government bonds have confidence in the Treasury. We all make mistakes, but so far I haven't. The reason the bond market is so healthy is that the figures that have come out since I have been here have been correct and not for some ulterior motive.

Q. On the first of May the total expenditures were about $3,000,000,000 and if you were going to have a deficit, including a deficit as large as $5,600,000,000, you would have to spend in addition to the bonus something like $1,000,000,000 a month if your revenue estimates are correct.

A. You are getting down to spending. The big difference in spending is Agriculture where they have not spend theirs on AAA. I don't know when Wallace will suddenly open up and pay, but the shortage is in AAA, but if Wallace would suddenly
pays the money to farmers on past contracts -- not future -- that thing could jump to within that figure. The amount that Wallace has paid on all AAA contracts is almost nil and that's where the difference is and I can't tell and nobody else that Wallace may pay the checks tomorrow. I don't think he has spent over 30 or 40 millions. That's where the difference is. Wallace may decide that he will pay that money tomorrow. I think the estimate was around $500,000,000 on all propositions and he is behind that much in his payments. That is the explanation and I did not want to say it because it brings in Wallace, but we are talking here among ourselves. Does that explain it?

Mr. Gaston: The boys are to get it for themselves and from Wallace's card records and it is not to come from you.

HM, Jr.: My guess is that less than $50,000,000 has gone out.

I don't know what I have said on the record and what I haven't. You have gotten under my skin a little -- at least you haven't, but Mr. May has. But I think everything I have said up to now is off the record until you get the letter. It is getting down to my integrity and I value that rather highly and I won't let Mr. Mary or anybody else besmirch it.

Q. Would you permit the earmarking of gold in New York for English account for the same purposes as China gold is earmarked?

A. I am sorry, I don't wish to answer that.

Q. Are you ready to tell us anything more about the Chinese?

A. No. But our progress is accelerating. Is that a good word?

Q. Yes.

When we get this letter from Senator Harrison, could we make this background?

A. What do you think, Herbert?

Mr. Gaston: I think it will all be in the letter -- all that is necessary.
Q. Just some personal touches?
A. That's all right. I feel very keenly about it. I don't mind your using it for background. If anybody could point to any group of figures I have given out since I have been here that have not been on the "up and up", I would like to know about it.

Q. Anything on the international money situation today?
A. No. The situation is still a nervous one.

Q. Is there any particular official reason why there should only be two New York banks very actively in the market?
A. No. That's purely up to them. It is a private commercial transaction and any New York bank can or cannot do it, as they wish.

Q. One in the past has been very closely identified with the activities of the Federal Reserve Bank.
A. It is purely voluntary on their part and they may think they want to invest in gold and bring it over and they may not, but it's purely voluntary. They make their own decisions without any guidance or hints from us.

Q. Is Senator Harrison getting more than one copy of this letter?
A. Yes, he asked me to send up enough copies.

Q. Would you care to say that the British are involved in this Chinese thing?
A. The Chinese Government sent these people over to see the United States Treasury.

Q. The reason I asked is the British have had a financial mission out there for sometime and since the Chinese work pretty closely with the United States and England I thought it reasonable they might be connected here.

A. I again say, the Chinese came over to see the United States Treasury. I hear the Japanese have some interest in
China, too!

Q. You did not hear that directly from the Japanese who came in to see you, did you?

A. Listen! Go on! No; this is a Chinese-United States situation; just between the two Governments; nobody else is in on it.
My dear Senator:

Senator King requested from the Department estimates of the yield of certain tax proposals, and I assume it is appropriate that I transmit them through the Chairman of the Committee. They are attached.

Very truly yours,

Secretary.

Honorable Pat Harrison,
Chairman, Senate Committee on Finance,
United States Senate

Enclosure
Estimated increase in revenue from income taxes under Senator King’s proposals, as compared with estimated revenue under the Revenue Act of 1935, based on calendar year 1936 incomes.

<table>
<thead>
<tr>
<th>Description</th>
<th>Increase in revenue (in millions of dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate income tax:</td>
<td></td>
</tr>
<tr>
<td>Rates graduated from 15 percent to 16 percent applicable to the same net income classes as under the Revenue Act of 1935 1/</td>
<td>208</td>
</tr>
<tr>
<td>Individual income tax:</td>
<td></td>
</tr>
<tr>
<td>Normal tax rate increased to 6 percent; personal exemptions reduced to $500 for single returns and $2,000 for joint returns; surtax rates increased in surtax net income classes below $62,000 2/</td>
<td>320</td>
</tr>
<tr>
<td>Total increase in revenue</td>
<td>528</td>
</tr>
</tbody>
</table>

1/ Corporate tax schedule - upon net incomes not in excess of $2,000, 15 percent; in excess of $2,000 and not in excess of $15,000, 16 percent; in excess of $15,000 and not in excess of $40,000, 17 percent; in excess of $40,000, 18 percent.

2/ Surtax rates begin at 6 percent on surtax net incomes in excess of $4,000, are graduated more steeply in the surtax net income brackets up to $62,000 than under the Revenue Act of 1935, and remain the same on surtax net incomes above that amount reaching a maximum rate of 75 percent on surtax net incomes in excess of $5,000,000.
My dear Senator:

Senator King requested from the Department estimates of the yield of certain tax proposals, and I assume it is appropriate that I transmit them through the Chairman of the Committee.

They are attached.

Very truly yours,

Secretary.

Honorable Pat Harrison,
Chairman, Senate Committee on Finance,
United States Senate

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Very truly yours,

Secretary.

Honorable Pat Harrison,
Chairman, Senate Committee on Finance,
United States Senate

Enclosure
Honorable Henry Morgenthau, Jr.,
Secretary of the Treasury,
Washington, D.C.

Dear Mr. Secretary:

It has been stated that many of our financially strong corporations, especially those of substantial size, will pay little or no taxes to the Federal Treasury if the pending bill is passed. I am checking the accuracy of these statements, and I am likewise interested in the opportunities that may be afforded such corporations by the bill to avoid the payment of taxes.

We must guard carefully against giving these large corporations a greater advantage and perhaps a stranglehold over their present smaller competitors. Frankly, I am concerned about the application of the proposed tax policies to those corporations which now have large surpluses and a strong cash or credit position.

We must make certain that legislation does not prevent the healthy growth and expansion of our smaller businesses by imposing a penalty upon them if their financial position and their business opportunities do not permit the payment in dividends of substantially all their profits. I want your assistance in appraising the situation.

I have selected from Moody’s Manual a few of the largest corporations, with a view to determining the rate of tax which would be imposed upon them if the pending bill should be enacted. The only statistics I have available are for 1934. I should appreciate it very much if you would check the list you give me and let me have a similar list for 1935, if statistics are available to you.

A FEW OF THE CORPORATIONS WHICH WOULD PAY NO TAX, BASED ON 1934 RETURNS. (Now Pay 15%)

<table>
<thead>
<tr>
<th>Company</th>
<th>Net Income After Tax</th>
<th>Dividends Paid Out.</th>
</tr>
</thead>
<tbody>
<tr>
<td>American Tel. &amp; Tel.</td>
<td>$121,748,729</td>
<td>$167,960,475</td>
</tr>
<tr>
<td>American Tobacco Co.</td>
<td>24,084,280</td>
<td>26,590,858</td>
</tr>
<tr>
<td>Amer. Smelting &amp; Refining</td>
<td>7,583,202</td>
<td>7,875,000</td>
</tr>
<tr>
<td>General Electric Co.</td>
<td>19,726,044</td>
<td>19,381,453</td>
</tr>
<tr>
<td>Goodyear Tire &amp; Rubber Co.</td>
<td>4,287,664</td>
<td>4,508,907</td>
</tr>
<tr>
<td>International Harvester</td>
<td>3,948,637</td>
<td>8,264,040</td>
</tr>
<tr>
<td>Natl. Biscuit Co.</td>
<td>11,597,573</td>
<td>19,939,342</td>
</tr>
<tr>
<td>Natl. Dairy Products Co.</td>
<td>6,551,930</td>
<td>8,197,573</td>
</tr>
<tr>
<td>Ohio Oil Co.</td>
<td>5,411,924</td>
<td>6,294,728</td>
</tr>
<tr>
<td>R. J. Reynolds Tobacco Co.</td>
<td>21,536,894</td>
<td>30,000,000</td>
</tr>
<tr>
<td>Texas Company</td>
<td>5,585,205</td>
<td>9,348,820</td>
</tr>
</tbody>
</table>

The above list of financially strong companies that can completely avoid taxation can be greatly expanded.
## CORPORATIONS WHICH WOULD PAY LESS THAN 5 PER CENT

<table>
<thead>
<tr>
<th>Company</th>
<th>Net Income After Tax</th>
<th>Dividends Paid Out</th>
<th>Tax under New Bill</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fire Reduction</td>
<td>4,145,416</td>
<td>3,737,142</td>
<td>2,822</td>
</tr>
<tr>
<td>Allied Chemical &amp; Dye Corp.</td>
<td>17,548,355</td>
<td>15,703,374</td>
<td>3,400</td>
</tr>
<tr>
<td>Corn Products Refining Co.</td>
<td>9,702,696</td>
<td>5,500,000</td>
<td>1,220</td>
</tr>
<tr>
<td>Artis Publishing Co.</td>
<td>5,706,326</td>
<td>5,878,194</td>
<td>3,500</td>
</tr>
<tr>
<td>I. dupont</td>
<td>46,701,465</td>
<td>3,572,193</td>
<td>4,000</td>
</tr>
<tr>
<td>Firestone Tire &amp; Rubber</td>
<td>4,154,656</td>
<td>30,000</td>
<td>1,20</td>
</tr>
<tr>
<td>General Foods</td>
<td>11,143,676</td>
<td>9,300</td>
<td>4,40</td>
</tr>
<tr>
<td>Beat Western Sugar</td>
<td>5,761,727</td>
<td>5,370</td>
<td>1,55</td>
</tr>
<tr>
<td>Imperial Oil Co.</td>
<td>14,101,561</td>
<td>13,415</td>
<td>1,40</td>
</tr>
<tr>
<td>Bigelow &amp; Myers Tobacco Co.</td>
<td>20,086,691</td>
<td>17,200</td>
<td>4,16</td>
</tr>
<tr>
<td>Barke, Davis &amp; Co.</td>
<td>8,719,368</td>
<td>6,232</td>
<td>1,50</td>
</tr>
<tr>
<td>Pennsylvania Railroad Co.</td>
<td>13,377,839</td>
<td>13,214</td>
<td>30</td>
</tr>
<tr>
<td>&amp; S. Smelting &amp; Refining</td>
<td>6,052,968</td>
<td>6,000</td>
<td>25</td>
</tr>
</tbody>
</table>

## CORPORATIONS WHICH WOULD PAY LESS THAN 10 PER CENT

<table>
<thead>
<tr>
<th>Company</th>
<th>Net Income After Tax</th>
<th>Dividends Paid Out</th>
<th>Tax under New Bill</th>
</tr>
</thead>
<tbody>
<tr>
<td>American Can Co.</td>
<td>19,522,945</td>
<td>15,256</td>
<td>6,63</td>
</tr>
<tr>
<td>Armour &amp; Co. (Del)</td>
<td>6,235,835</td>
<td>5,899</td>
<td>8,84</td>
</tr>
<tr>
<td>Eastman Kodak Co.</td>
<td>14,503,267</td>
<td>10,493</td>
<td>8,54</td>
</tr>
<tr>
<td>General Motors</td>
<td>94,769,131</td>
<td>73,621</td>
<td>6,78</td>
</tr>
<tr>
<td>Great A &amp; P Tea Co.</td>
<td>20,476,160</td>
<td>16,430</td>
<td>7,78</td>
</tr>
<tr>
<td>International Shoe Co.</td>
<td>8,967,024</td>
<td>6,671</td>
<td>7,78</td>
</tr>
<tr>
<td>J. C. Penny Company</td>
<td>16,147,315</td>
<td>12,307</td>
<td>9,37</td>
</tr>
<tr>
<td>Phillips Petroleum Co.</td>
<td>5,757,309</td>
<td>4,156</td>
<td>8,30</td>
</tr>
<tr>
<td>Proctor &amp; Gamble</td>
<td>14,370,067</td>
<td>10,512</td>
<td>8,30</td>
</tr>
<tr>
<td>Socony-Vacuum Oil Co.</td>
<td>24,121,297</td>
<td>18,652</td>
<td>6,90</td>
</tr>
<tr>
<td>Standard Oil Co. (Calif.)</td>
<td>18,367,807</td>
<td>13,069</td>
<td>8,85</td>
</tr>
<tr>
<td>Standard Oil Co. (Ind.)</td>
<td>18,949,690</td>
<td>15,371</td>
<td>5,63</td>
</tr>
<tr>
<td>Standard Oil Co. (N.J.)</td>
<td>67,882,271</td>
<td>54,204</td>
<td>6,08</td>
</tr>
<tr>
<td>Texas Gulf Sulphur Co.</td>
<td>6,958,476</td>
<td>5,730</td>
<td>5,22</td>
</tr>
<tr>
<td>United Fruit Co.</td>
<td>12,049,300</td>
<td>8,717</td>
<td>8,69</td>
</tr>
<tr>
<td>F. W. Woolworth Co.</td>
<td>32,112,363</td>
<td>23,027</td>
<td>8,54</td>
</tr>
</tbody>
</table>

I also ask that you furnish me with the names of all corporations which, for the last year for which the statistics are available, had a net income, before Federal taxes, of more than $1,000,000, and, based upon the actual distributions for the year, will receive a tax reduction of fifty per cent or more under the pending bills.

You will appreciate that the fundamental purpose of my inquiry involves not only competitive advantages to the strong corporations, but the restraints of heavy taxes upon small and medium sized enterprises upon which we must depend so largely for re-employment of labor, and for healthy business growth.

It is unnecessary for me to add that the data must be available promptly if it is to serve a useful purpose. I shall appreciate very much your assistance and cooperation.

Cordially yours,

(Signed) HARRY F. BYRD

Regraded Unclassified
May 8, 1936

HM, Jr. had the following meeting with him in his office today: Upham, Hass, Bell, Taylor, Gaston and Oliphant.

The Secretary said, "I have two suggestions to make. (1) This fellow May ranks as a No. 1 accountant and has great standing and reputation among business people, and I think it would be a very smart move if we could get someone of equal standing to check the Treasury's estimates and tell us whether we are correct. Haas' reaction was, "It is not an accountant's job. It is not in his field. I could lose him if I wanted to." HM, Jr. then asked him, "Well, who would have?" And Haas replied, "It happens to be my responsibility and I am leaving myself out of it, but as I see the whole thing, they must attack something and they are attacking the estimates. It is a sign of weakness to have somebody come in a recheck our figures. Estimates can't be checked. The thing to do is to sit tight." HM, Jr. inquired of Haas, "So you rely entirely on McLeod?" and Haas answered, "No. We have others who go over his figures." HM, Jr. reminded Haas that the same mistake was made in the President's speech and, he said, "You had two months to find that out, but you didn't."

Turning to Bell, the Secretary said, "You have the background of the Treasury. How would you feel if I brought somebody down? Inasmuch as our figures have been questioned, I want them double checked and analyzed." Bell's reply was, "I do not think it is a sign of weakness to ask somebody from the outside to recheck our figures. The trouble is to get someone who is fair and who afterwards would not go out and seek a lot of publicity." In answer to that, HM, Jr. said, "I have had people in to talk to me from time to time and no one knew that they were down here. On the question of gold devaluation, I had Parker Gilbert down here. He has never told a living soul that I know of."

Continuing, HM, Jr. said, "I don't want to answer May publicly. I will ask the man to come down with the distinct understanding that I may or may not use his figures, but I want him to come down in a confidential capacity, in the same relationship that exists between a doctor and a patient." Haas remarked, "Oh! On that basis, that's different. Then I am in agreement. But I still don't think you ought to get an accountant." Bell remarked that "May is an actuary, an economist and an accountant."
Speaking to the whole group, HM, Jr. said, "Well, I wish that you would all think about it and bring in some suggestions and meet again at 12 o'clock. I would say that for my own satisfaction, I want to have these figures rechecked; that if we have slipped, I want to say so. I am big enough to say so, if you don't mind my saying so. After reading my statement in the papers this morning, I am perfectly satisfied. It was the clean-cut, manly thing to do."

He said to the group, "The second suggestion that I have to make is that I mentioned the names of Professor Hague of Columbia, to the President and he said 'thumbs down'. My idea was to have this man check what we are doing on the policy of the bill. I am not worried about the bill draft, but I want a fresh mind on the policy." Oliphant said that he did not know Professor Hague.

HM, Jr. again spoke to the group of the suggestion that it might be well to keep the flat rate on corporation income, and in this way assure the collection of a substantial amount of revenue, and then add to that flat tax a graduated or another flat tax on undistributed earnings. The figures suggested were a 15% flat tax and a 15% supertax. He said, "By getting all this revenue from the rich corporations we could possibly reduce the tax for the small man who has an income of $2500." Oliphant said, "If we change the bill now, we will have no bill," to which HM, Jr. said, "Suppose we do get up against a stone wall. Then what? I, therefore, suggest that we have an alternative bill in our vest pocket."

Haas had the following to say: "Our estimates have been made on the assumption that all this income would be subject to tax. If it leaks through this person you will bring down, then you will not get the revenue." Oliphant said, "I worked on the theory that Haas' estimates were correct. I have every confidence in the basis on which McLeod made his estimates. If any of you know of any loopholes, I wish you would talk about them." Haas added, "If there are any loopholes, I can't take the responsibility." HM, Jr. wanted to know if Oliphant took the responsibility of the loopholes, and Oliphant answered, "Yes, I do." Upham stated, "The people on the Hill are not as confident that the leaks have been filled as Mr. Oliphant is."

HM, Jr. then said to the group, "Well, I think this has
been a good meeting. First, we are trying to get a man like May to advise the Treasury in a confidential capacity on the mathematical end and, second, we are trying to get an outside person, like Magill, who is not in private practice to get his views on the policy. If I do this, nobody can ever say that the Treasury left a stone unturned to see that this bill will do what we say it will do."

Gaston offered the following suggestion: "What would you think of the suggestion that we send up our estimates on the Hill and say that this is how we arrived at our figures."

Haas' reaction was, "I think we first ought to get the accountant, whom you are bringing down, to check our estimates and then if they are sweet, send them up." HM, Jr. thoroughly agreed with Haas.
At 12 o'clock today, Oliphant, Upham, Taylor, Gaston, Bell and Haas met with the Secretary.

HM, Jr. said, "Someone has suggested Professor Mills of Columbia. Oliphant said he did not know who he was and Haas said he did not think well of him. The Secretary asked Oliphant to check up on Professor Mills and said, "I understand that Professor Mills has written a book on sources of income and I had him in mind to advise us on the policy of the bill." Oliphant's comment was, "I do not know of anyone better than Viner," but HM, Jr. disagreed, saying "No, not on this thing."

Continuing, the Secretary said, "A Mr. Niven, of Touche, Niven & Co., has been suggested as an accountant and Mr. Staub, of Lynand, Rose and Montgomery," Taylor said, "I would like to suggest the name of Arthur Anderson as the accountant. He is outstanding in every way." Upham thoroughly agreed with Taylor and Mrs. Klotz reminded HM, Jr. that Earle Baille, in his telephone conversation with the Secretary this morning, had mentioned the name of Anderson. The Secretary immediately put in a long distance call for Arthur Anderson, but was unable to get him before he left the office at one o'clock.

At this meeting, Mr. Taylor suggested an alternate plan and Oliphant asked him to make copies available to the group and they would look into it.
In elaboration of the suggestion which I made at the meeting held in your office on Friday, May 8, 1936, I am listing below certain modifications which might be made in the proposed tax bill:

1. Differentiate between "business income" and income from "investments".

2. Place "business" whether conducted by individual, partnership or corporation on same tax base.

3. Retain principle of graduated rates for business income, based on ability to pay. Give favorable treatment to or exempt "business income" in low brackets.

4. Place "investment income" whether received by individual, partnership or corporation on same tax base, if retained.

5. Tax investment income paid to foreign individuals at flat rate, tax to be withheld at source. Tax investment income paid to foreign corporations at higher flat rate, tax to be withheld at source.

6. Place banks, insurance companies, bona fide investment trusts and other financial institutions which obviously must depend on income from investments in special category when considering income from investments.

7. Exempt investment income from wholly owned subsidiaries operating in the same "business" classification from "investment income" graduated tax but include in "business" earnings of parent company.

8. Possibly place public utility and railroad investment income from controlled but not wholly owned subsidiaries or affiliates in a special category.
As you know, my only purpose in suggesting these modifications is in order to provide some secondary plan if the extant proposals encounter insurmountable difficulties. You will notice that most of the basic principles are retained but their application is altered.

My impression is that the gamble on the amount of revenue is reduced and that we would be dealing with fewer unknown factors.

I particularly direct your attention to the fact that profits from business if retained for reserves must either be invested in tax-exempt securities, or the income from taxable securities must be distributed to stockholders, if high surtax rates are to be avoided. The effect of this provision on personal holding companies and on the investment by business corporations in speculative securities unrelated to their own business is obvious, and means legitimate reserves will be invested in short-term Government's or other tax-exempt securities. This is certainly sound practice, as in the past far too many corporations have dissipated earnings as a result of ill-advised investments in speculative market securities with a consequent loss to the stockholders as well as loss of revenue to the government.

The suggested treatment for foreign individual and corporate holders might well be considered without reference to the other suggestions as it meets in part the problem of personal holding companies incorporated in Canada and elsewhere.

I believe that the differentiations between business income and investment income will stimulate private productive enterprise, and that a slight discrimination in favor of unincorporated individual enterprises is not only justified but a step to be encouraged.
SENATE BACKERS WAVER ON ROOSEVELT TAX PLAN; HARD FIGHT IN PROSPECT

NEW PROPOSALS IN MIND

Connally Maps Tentative Plan, Basing it on Present Law.

DEFENSE BY MORGENTHAU

Possible Ambiguity in Phrasing Does Not Alter Estimate of Yield, He Replies.

ACCOUNTANTS ASSAIL BILL

Through V. H. Stempf They Say Future of Medium-Sized Companies Is Jeopardized.

WILLIAM D. KEEFER - SPECIAL TO THE NEW YORK TIMES

WASHINGTON, May 7. - A week of constant bombardment by business and Industry against President Roosevelt's new tax program apparently was beginning today to have effect upon the Senate Finance Committee, and indications were developing fast that the administration will have the fight of the year if it holds out for the plan, particularly the proposed new corporate levy based solely on undistributed profits.

Of a total of nearly 100 witnesses who appeared before the committee, only the Treasury spokesmen had thus far supported the proposals as enacted by the House, and committee members who heretofore had been regarded as favorable were either dropping away or beginning to waver, at least to the extent of curtailing other plans of taxation.

Senator Connally, Independent Republican, who at the start had been counted upon to favor the bill, was reported to have changed his position in light of the testimony of the last three days. Senator Connally, until today a friend of the undistributed corporate profits tax embodied in the House bill, began working in earnest on a plan of his own.

Estimates on Other Plans Sought

The tentative proposal of Senator Connally, who, incidentally, has written more amendments into revenue bills during the last four years than perhaps any other Senator, involved retention of the present corporate income tax and the superimposition of a moderate levy on undistributed profits along the main line suggested in an editorial in The New York Times of May 4.

Senator Connally asked Treasury experts for estimates on the probable additional revenue yield from such a combination, with a flat corporate income tax rate of 12 1/2 per cent and an undistributed profit surtax of 12 1/2 per cent. He explained that this proposal was only tentative, and that he had asked for the estimates only as a basis for further perfection of his plan.

"I believe, however," he said, "that we can work out something along these lines."

Meanwhile, Senator Know asked for estimates on the full plan proposed by The New York Times, including, first, retention of the corporate income tax at a flat rate of 15 per cent; second, imposition of the full normal and surplus rate on corporate dividends in the hands of stockholders, and, third, an additional levy on undistributed profits, starting at 4 per cent on the first 20 or 25 per cent of corporate income withheld from distribution and a graduated tax of from 5 to 20 per cent on withholdings in excess of that percentage, with specific exemptions from this levy for amounts withheld for plant expansion and replacements.

Senator King also asked for estimates on a plan of his own to reduce the personal exemptions from the individual income tax and increase the rates in the lower and middle brackets, and a higher corporate income levy.

Favor $2,00,000,000 More Yield

While all of these developments indicated nothing more than possible future steps, members of the committee felt that they could find a tax that would yield the $2,00,000,000 in permanent annual new revenue sought by the President the undistributed profits tax might be scrapped as recommended by every representative of business who has appeared at the hearings.

I only qualification to such a prediction was the feeling that if the administration's attitude would be in case the program were so modified. Some Senators said they had been good authority that if a plan such as the President's plan it might win in the long run, the House has adopted the plan by a majority of nearly three to one.

There was no definite indication, however, as to what the administration's attitude would be in case the program were so modified. Some Senators said they had been good authority that if a plan such as the President's plan it might win in the long run, the House has adopted the plan by a majority of nearly three to one.

Morgenthau Writes to Harrison

The only representatives made to the committee by the Treasury since it completed its testimony last week, or the only answer to any of the attacks, was a letter addressed to Chairman Harrison today by Secretary Morgenthau in which he replied to the assertions made yesterday by Cease O. Mayo, senior partner of Price, Waterhouse & Co., certified public accountants, who had uttered a "manifest statement" in his testimony in support of the House bill.

Mr. Morgenthau had said that under the present law $4,500,000,000 of corporate income would be withheld from stockholders during the calendar year of 1936, with a resultant loss to the government of about $1,100,000,000. A perusal of this figure was the result of the work of the existing corporation tax rates whereby corporations would be able to get about $1,100,000,000 in revenue to the government.

They condemned this as a "manifest statement" because it established the figure of $4,500,000,000. In a letter to the New York Times Mr. Morgenthau said that the $4,500,000,000, or practically one-fourth of the amount, would accrue to the Treasury from the repeal of the present corporation tax laws.

In reply, Mr. Morgenthau said that in the terms as he used them, but insisted that he had not in any way the Treasury's estimate of the probable yield from the new
THE MORGENTHAU LETTER

Secretary Morgenthau's letter to Senator Harrison follows:

"My dear Senator:

I have read the statement which I made before your committee on April 29 was challenged. The particular part of the statement was the following:

"The department has also estimated that under the present laws more than $4,500,000,000 of corporation income in the calendar year 1936 will be withheld from stockholders, and that if these incomes 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 $1,300,000,000."

"I can see that the phrase 'withheld from stockholders' was possibly open to misunderstanding inasmuch as the figure $1,300,000,000 arrived at was after we had deducted from the $4,500,000,000 an amount equal to the existing corporation taxes.

"What I have just said about a possible ambiguity in the use of this term relates to one of my arguments on the merits of the proposed corporate tax, but at all in my statement of the Treasury's estimate of what this tax would yield. The estimate is $603,000,000 additional revenue.

"Sincerely yours,

"HERBERT MORGENTHAU JR.
"Secretary of the Treasury."

Manufacturers Oppose Bill

The business attack against the corporate profits tax was continued today by the National Association of Manufacturers. Noel Sargent, economist, and James A. Emery, general counsel of the Manufacturers Association, repeated substantially the testimony given by the organization's spokesman to the Ways and Means Committee in the initial consideration of the bill, to the effect that it would be crippling to business, and of doubtful revenue advantage.

"The measure is not merely a tax proposal," Mr. Sargent said. "It must be considered a regulatory measure and as a form of deliberate national economic planning. It is a further step toward government regulation and regimentation of business."

Mr. Sargent urged that the Finance Committee discard the bill and that a special committee of Congress be set up to study a fundamental revision of the Federal revenue structure.

Mr. Emery said the bill would ruin the tax system and retard business pioneering, which must proceed if recovery is to come and substantial plan suggested.

A substitute for the pending bill, including a broader income-tax base and a moderate levy on unincorporated corporate income, was proposed to the committee by V. H. Stempf of New York in behalf of the committee on Federal taxation of the American Institute of Accountants.

Mr. Stempf avoided a discussion of any of the technical questions involved in the proposed new corporate tax. He confined himself to the strict view of taxation from an economic view. In this connection, he cited one reason for abandoning the pending bill.

He filed a memorandum with the N.Y., representing F. N. Nitti of the committee setting forth in detail the objections of the accountants. The committee (the accountants) believe it is unwise to involve the great number of medium-sized corporations which are struggling by relieving corporations of the present capital tax in the extent to which it would more likely result in a broad distribution of the tax in full, by imposing a base of taxation at high rates. Along with that factor, he argued, too, he is based on the fact that simplification has at its maximum, 5 per cent not been attained or even approached.

"The recommendations presented by Mr. Stempf included:

"Retention of the present corporate income tax at present rates in a fixed 1-in-10 percent tax.

"A reduction in personal exemption for income tax purposes, the net interest tax by the United States upon the income of other countries, and the increase in the corporate income tax by the United States upon the income of other countries."
could not be shown or paid in cash, although this profit would be subject to the full weight of the levy on undistributed earnings.

A special plea on behalf of the mining industry for abandonment of the proposed profits tax was made by Julian D. Conover of Washington, secretary of the American Mining Congress; A. G. MacKenzie of Salt Lake City, representing the State Association of Metal Mine Operators and Donald A. Callahan of Wallace, Idaho, representing the Idaho Mining Association. They argued, in effect, that the hazards and fluctuations of the mining business would render them special victims of such a tax.

M. E. Peloubet, member of the firm of Pogeon, Peloubet & Co., certified public accountants of New York, also representing the American Mining Congress, suggested an administrative amendment relating to inventories which, he said, would make it possible for taxpayers to report as taxable income the income which is "realizable," rather than the income which is the result of arbitrarily writing up or writing down assets.

For Life Insurance Amendment

Lawrence A. Baker, general counsel for the National Association of Life Underwriters, asked the committee to amend the bill to exempt the proceeds of life insurance policies applicable to the payment of estate, inheritance and other death duties. Senator Loneran of Connecticut, member of the committee, subsequently announced that he would sponsor such an amendment.

L. W. Tallafarro of Detroit, representing the Hammond Standish Company, continued the plea of independent backers for relief from the "windfall" levy to recoup former impounded or unpaid processing taxes.

H. W. Storey of Milwaukee, representing the Allis-Chalmers Manufacturing Company, made a frontal attack on the whole bill. He said it created more inequities than the existing law, and further that if it fixed a dividend policy for a corporation without any regard for its needs, he related that his own company had re-employed 1,800 men since Jan. 1, but that if it could not keep sufficient of its earnings for reserves it could not employ more or keep those now on the payrolls at work.

A brief filed with the committee by C. H. Mylander of the American Bankers Association urged revision of the bill to continue the present exemptions of dividends paid on bank stock from the normal income tax rates. He urged that the other special treatment of banks as carried in the House bill be retained.
Anti-Tax Bill

Democrats May

amend

Force Revision

Corporation Levy Proposal

Morganthau Replied to May

Admits Possible Ambiguity in Statement on Revenues

From the New York Tribune

WASHINGTON, May 6.—A major revision of the Administration program, which has an estimated income of $3,000,000,000 for corporations appeared to be losing ground today, when there were very definite indications that a bloc of Democrats of the Senate Finance Committee were in revolt against the House tax bill and were discussing a variety of substitute plans.

These democratic members of the committee, including principal those labeled "conservative," were frank to say that a week of solid business opposition to the proposed bill was helping its effect. While they declined to go on record until after executive session, it appears that a compromise amendment for tempering the revolutionary tax plan, either by imposition of an undistributed corporate income tax only as an extension of an existing surtax or by scraping the new proposal and basing the levy on existing corporate tax or to obtain additional revenue.

Morganthau Answers May

Talk of extensive changes in the tax bill by Morganthau Jr., Secretary of the Treasury, in a letter to Senator Pat Harrison. Democratic chairman of the committee, admitted that a statement which has been made before the Senate committee might have included an ambiguity. Mr. Morganthau was answering a charge by George O. May, nationally known statistician, that the Secretary of the Treasury had been guilty of an "obscure and serious misstatement of fact."

While reporters had been given the impression that the Secretary of the Treasury would make comprehensive answer to Mr. May's contention that the pending tax bill would not increase the revenue that might be expected under existing law, Mr. Morganthau's letter simply reiterated that the Treasury estimate was that $2,000,000,000 of additional revenue could be obtained under the proposed new tax.

Letter in Harrison

The Secretary of the Treasury wrote a letter to Senator Harrison as follows:

"Yesterday part of the statement which I made before your committee from May 4 was challenged. The particular part of the statement was the following from the Department: The letter estiated that under the present law more than four and one-half billion dollars of corporation income for the calendar year 1935 will be

Day in Congress

From the New York Tribune

WASHINGTON, May 7.—The activities in Congress today were:

SENATE

Meets at noon.

Adopted conference report on the Army appropriation bill.

Adopted conference report on the appropriation bill for state, justice, commerce and labor departments.

Debated the Navy appropriation bill.

Passed at 4:10 until noon tomorrow.

HOUSE

Meets at 11:30 a.m.

Began debate on the relief appropriation bill.

Adjourned at 5:30 until 11 a.m. tomorrow.

written from Rockefeller, and that

if this income was being distributed to the individual owners of the stock it represented to these corporations the incomes. Senators William D. King, of Delaware, and W. W. Harriman, of Utah, present tentative income taxes would be about $700,000,000, or an amount equal to the existing corporate tax. However, it was stated by those who favored the bill that it would be necessary to exempt bank dividends from the normal individual tax.

The A.B.A. pointed out that the country's banks own the government surplus, and the amount could only be paid through accumulated earnings or through stock dividends from the normal individual tax.

The A.B.A. pointed out that the country's banks own the government surplus, and the amount could only be paid through accumulated earnings or through stock dividends from the normal individual tax. However, if the tax was imposed, the banks would have to be paid for the stock. The bankers' associations also protested the severe tax rates of the holding company income. The pending bill pointed out that there were two underlying assumptions in the tax. The first is that the banks holding companies holding the stock of the banks would be required to pay corporate taxes on the following amounts: for corporate purposes of $4,000,000,000 of property. These holding companies are required to retain a certain amount of their income, and the rate of taxation is based on the amount of their income.
UNITED STATES SENATE
Committee on Finance

May eighth, 1936.

Honorable Henry Morgenthau, Jr.,
Secretary of the Treasury,
Washington, D. C.

My dear Mr. Secretary:

It has been stated that many of our financially strong corporations, especially those of substantial size, will pay little or no taxes to the Federal Treasury if the pending bill is passed. I am checking the accuracy of these statements, and I am likewise interested in the opportunities that may be afforded such corporations by the bill to avoid the payment of taxes.

We must guard carefully against giving these large corporations a greater advantage and perhaps a stranglehold over their present smaller competitors. Frankly, I am concerned about the application of the proposed tax policies to those corporations which now have large surpluses and a strong cash or credit position.

We must make certain that legislation does not prevent the healthy growth and expansion of our smaller businesses by imposing a penalty upon them if their financial position and their business opportunities do not permit the payment in dividends of substantially all their profits. I want your assistance in appraising the situation.

I have selected from Moody's Manual a few of the largest corporations, with a view to determining the rate of tax which would be imposed upon them if the pending tax bill should be enacted. The only statistics I have available are for 1934. I should appreciate it very much if you would check the list I give you and let me have a similar list for 1935, if statistics are available to you.

A FEW OF THE CORPORATIONS WHICH WOULD PAY NO TAX,
BASED ON 1934 RETURNS - (Nov 17, 1935)

<table>
<thead>
<tr>
<th>Company</th>
<th>Net Income After Tax</th>
<th>Dividends Paid Out</th>
</tr>
</thead>
<tbody>
<tr>
<td>American Tobacco Co.</td>
<td>$112,748,768</td>
<td>$107,390,476</td>
</tr>
<tr>
<td>A. S. Smelting &amp; Refining</td>
<td>7,585,202</td>
<td>7,575,000</td>
</tr>
<tr>
<td>General Electric Co.</td>
<td>19,726,044</td>
<td>19,821,453</td>
</tr>
<tr>
<td>Goodyear Tire &amp; Rubber Co.</td>
<td>4,067,654</td>
<td>4,508,907</td>
</tr>
<tr>
<td>International Harvester</td>
<td>5,948,657</td>
<td>6,264,040</td>
</tr>
<tr>
<td>Natl. Biscuit Co.</td>
<td>11,597,575</td>
<td>12,939,542</td>
</tr>
<tr>
<td>Natl. Dairy Products Co.</td>
<td>6,561,920</td>
<td>6,197,575</td>
</tr>
<tr>
<td>Ohio Oil Co.</td>
<td>5,111,924</td>
<td>5,294,728</td>
</tr>
<tr>
<td>R. J. Reynolds Tobacco Co.</td>
<td>21,528,684</td>
<td>30,000,000</td>
</tr>
<tr>
<td>Texas Company</td>
<td>5,645,205</td>
<td>9,348,620</td>
</tr>
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The above list of financially strong companies that can completely avoid taxation can be greatly expanded.

<table>
<thead>
<tr>
<th>CORPORATION WHICH WOULD PAY LESS THAN 50 PER CENT</th>
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<tbody>
<tr>
<td>Company</td>
</tr>
<tr>
<td>American Can Co.</td>
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<tr>
<td>Armour and Co. (DeL.)</td>
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<tr>
<td>Eastern Ice Co.</td>
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<tr>
<td>General Motors</td>
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<tr>
<td>Great Atlantic Tea Co.</td>
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<td>International Shoe Co.</td>
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<tr>
<td>J. C. Penny Company</td>
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<tr>
<td>Phillips Petroleum Co.</td>
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<tr>
<td>Proctor &amp; Gamble</td>
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<tr>
<td>Security-Vacuum Oil Co.</td>
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<tr>
<td>Standard Oil Co. (Calif.)</td>
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<tr>
<td>Standard Oil Co. (Ind.)</td>
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<tr>
<td>Standard Oil Co. (N.J.)</td>
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<tr>
<td>Texas Gulf Sulphur Co.</td>
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<tr>
<td>United Fruit Co.</td>
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<tr>
<td>F. W. Woolworth Co.</td>
</tr>
</tbody>
</table>
I also ask that you furnish me with the names of all corporations which, for the last year for which the statistics are available, had a net income, before Federal taxes, of more than $1,000,000, and, based upon the actual distributions for the year, will receive a tax reduction of fifty per cent or more under the pending bill.

You will appreciate that the fundamental purpose of my inquiry involves not only competitive advantages to the strong corporations, but the restraints of heavy taxes upon small and medium sized enterprises upon which we must depend so largely for re-employment of labor, and for healthy business growth.

It is unnecessary for me to add that the data must be available promptly if it is to serve a useful purpose. I shall appreciate very much your assistance and cooperation.

Cordially yours,

(Signed) Harry F. Byrd
I asked him whether the much talked of squeeze of the shorts in foreign exchange had been suspended on the Paris Bourse. Bolton thought that it seemed unlikely that as some of the reports indicated. Bolton had heard from the speculators that there was undoubtedly a serious amount of speculation going on, and that although he had heard of it he did not believe it to be true. At 8 o'clock and nothing in the world will induce it thereafter to do anything until the following morning. Meanwhile the pressure on the franc continued and the question was how long the French could hold out. I referred to the rumor circulated here that future dealings in London would happen in France over the weekend. Personally, it did not seem right to expect that something would happen in France over the weekend. Personally, it did not think that any one would be a panic. Weakness of the guilder he thought, could in part share that opinion. Weakness of the guilder, he thought, could in part share that opinion.

I called Mr. Bolton at 8:15 P.M. today. He reported that the day had not been quite as bad as yesterday, when there had practically been a panic. The Bourse was a trifle quieter but the export of capital was proceeding at much the same pace. There had been a very distinct weakening this afternoon of the position of the Dutch and the Swiss currencies probably because everybody seemed to expect that some-
cover, would be strong enough to reestablish public confidence. As he
put it, confidence would have to come first. Needless to say, they
would like nothing better than to see a few of the speculators run.

I inquired as to the size of his operations today and Bolton
replied that they had been about the same as usual. (We have since
learned that they are estimated to have been in the neighborhood of
250,000,000 francs.) Engagements for New York, he estimated at about
$10,000,000. (Total reported to us by New York banks is $10,395,000.)
The demand for gold in London, Bolton said, continued to be tremendous,
both sovereigns and eagles being quoted at quite a premium. The London
price for gold bars had risen from 140 shillings and 5 pence halfpenny at
the fixing to 140 shillings and 7 pence late in the afternoon. The
latter figure works out about $35 per ounce delivery in London.

Everybody, Bolton thought, had the jitters this weekend.
May 8, 1934

This was prepared by the Secretary, but it was not necessary to give it to the President.
During a discussion on Housing yesterday, you casually mentioned the fact that you were having difficulty in bringing CCC camps to the full enrollment. You further dropped the remark that you might have to go outside of the relief families for future candidates for the CCC camps and might take boys from families whose income did not exceed $500 a year.

It seems to me if this principle were applied to the CCC boys, it would not be very long before we would be giving work to families from the same class and the chances of our reducing the annual expenditures for unemployment would go out the window.

I believe I am right in saying that the reason you are having difficulty in getting more CCC boys is because they are finding employment and that is, of course, what we want. If we extend this opportunity to boys coming from families who have some income, I just cannot see any end to the road of deficits.

Up to now, I have been entirely satisfied with the fiscal picture and I can see a balanced budget coming before we will have to resort to the printing press, but once we begin to use Federal funds for families who are not in need I really
would become alarmed over the future of the fiscal foundation of your Administration.
May 8, 1936

I called the President at 9:15 this morning.

I told him that Cochran, in our telephone conversation this morning, had said that the market in Paris was very nervous; that Parker Willis had sent a cable over that we had entered into an agreement with England on stabilization; that Cochran had asked what he should answer them and I facetiously said, "Say that he is just another professor."

The President suggested putting someone on Parker Willis' statements with the idea that someone ought to make a radio talk -- not he, the President, nor I -- and talk about misinformation by some Americans, disloyalty of some Americans, to their own Government; that one American sends information to Paris who just in a short space of a year has made so many false statements that he has seriously hurt the position of the country. "I think it would be interesting to do this," the President said.

I then told the President that I had asked the men in the Treasury to set up all of Parker Willis' statements to date. They will put these on one page and on another page prepare another statement showing how incorrect his statements have been.

I also had the following to tell the President: I saw Pat Harrison and he is going to want to see you and wants to change the whole bill. Before he sees you, however, I think the Treasury boys and I ought to have a 'dress rehearsal' with you. I said to Pat, 'I have not talked to the President about the bill since you and I talked together and I do not want to change my position before you and I see the President again.' I told him that because I was afraid that if I talked too much about it, he might quote me. I also told the President of Pat Harrison's suggestion that in addition to the present flat rate on corporate income, there be an added flat tax on undistributed earnings. The figures Pat used were a 15% flat tax and a 15% supertax unless more than 30% of the corporation earnings were withheld, in which case he would recommend a graduated supertax on the withheld earnings.

I also said to the President, Pat Harrison also told me that Gifford, of A.T. &T., had said that if this bill went through, he would pay no tax as against paying $30,000,000 now. Pat's suggestion would make him pay something. I am
thinking of bringing down a national accountant, I told the President, to analyze our figures in order to answer May. I asked him, "Do you know Hague of Columbia? Do you think well of him?" and the President replied, "No; I do not think well of him. I put him on the original St. Lawrence Investigatory Board. He brought in a very wishy-washy report and I finally had to swing over the way way. He did not stand up."
Friday
May 8, 1936

Strange as it may seem I'm in a very good humor.

Good!

Because I think that I made a straight-forward answer to Mr. May where everybody sort of wanted me to kind of duck it.

I think you were a hundred percent right.

And, I gave - I mean I made a perfectly honest answer. Well, didn't you feel that way?

Yes, I felt exactly that way. In fact I said exactly that thing at the table this morning when I was reading it.

And I think that if we do make a mistake that the people have far more confidence in the Treasury if we say so.

Absolutely!

Yes

I mean there's no patent on perfection any place.

No

Even Mr. May's article I think in one or two places was --

Oh, yes, now - that leads me up to what I want to ask you in confidence - I thought that I might want to bring down whoever the head of Ernst & Ernst is and let them look at our figures and then tell us whether our bases for our estimates are right or wrong. What would you think of that?

Well now, I don't know about that firm.

Yes

Let me tell you, I mean I don't know about their recent standing.

Yes

I do know that in the pre-depression day -

Yes
B: - in 1928 and 29 they were connected with a couple of rather phony situations and got criticized for it. What their standing now is, it must

HMjr: Yes

B: In other words if you're going to do this you want to do this with somebody who's - who is -

HMjr: The top of the heap.

B: Exactly. Well now, they aren't.

HMjr: Well, who is?

B: Well now, of course Mr. May is.

HMjr: I know, but I -

B: But I mean - I mean I'll just start with that.

HMjr: Yes

B: He is without any doubt recognized every place as the top man.

HMjr: Yes

B: Now there are four or five others, Rexford first -

HMjr: Yes

B: The trouble is that most of them have rather an English flavor to them. In other words, take for instance the people who do the - have done the work for us in the companies for so long - the Lloyd Printer Gibbons and Company -

HMjr: Yes

B: They have an excellent reputation.

HMjr: Yes

B: And yet there is nobody in that group, broad-gauge man -

HMjr: Yes

B: - who could possibly stand up against the type of man that May is.

HMjr: Yes
B: Now Arthur Andersen and Company are another excellent firm. But I don't know --

HMjr: Well, Earle, may I ask this? Has Ernst and Ernst possibly gone through a reorganization in the last two or three years?

B: Well now that's -- that I can find out. That's what I'll make my business to find out right away.

HMjr: And is -- possibly they've got a new president.

B: It may well be -- that may well be -- that -- I've really put them out of my mind seven years ago and haven't looked at them since just because of the -- of the criticism at that time which was well founded.

HMjr: Well --

B: On the other hand, you know, even the great firm of Price Water House --

HMjr: Yes

B: -- advised on the Lord Kilphan balance sheet --

HMjr: On the what?

B: On the Lord Kilphan balance sheet in England. And the Parker of Price Water House was indicted and tried over there.

HMjr: Who did they advise?

B: Lord Kilphan, who was the shipping man who was sent to jail.

HMjr: I know, Lord Kilphan?

B: Yes

HMjr: And it was Price Water House advised them?

B: The English Office of Price Water House advised them.

HMjr: Yes

B: I just point that out so as to show you that even God has specks on him. You get my point?

HMjr: Yes, but this fellow isn't God.
(Laughter) No, but he sometimes thinks he is. It's rather his --

HMjr: Yes, as a matter of fact, I could pull some of his testimony apart.

B: Well, I thought you could too.

HMjr: But that --

B: But I don't think it's productive.

HMjr: It isn't up to me.

B: Yes, I quite agree with you.

HMjr: Now listen, Earle, if you've got a half an hour would you mind phoning around --?

B: I'll get right to work on it and I'll spend the rest of the morning on it.

HMjr: And then will you call me back?

B: Yes, I'll -- what I'll try to find out is first about Ernst and Ernst --

HMjr: Yes

B: Second, I'll see if -- if I don't get a good answer there I will try to see if there isn't some outstanding accountant in one of the big firms whom I could heartily recommend to you as an independent person.

HMjr: That's right.

B: Now, I'll go right at it.

HMjr: Now, there is an advantage of having a firm that is nationally know.

B: Exactly.

HMjr: Now, the firms that you mentioned mean nothing to me. I never heard of them. Now that --

B: Yes, I get you. Well, - Lybrand Ross and Montgomery is another nationally known firm.

HMjr: Yes -- You see, to me Price Water House and Ernst and Ernst -- I've heard those names over and over again.

B: Yes -- well, now at the present time -- I don't hear. I mean, they don't convey that to me. But --
HMjr: No, but I'm the 'man on the street', you see?
B: I get you.
HMjr: And I suppose - and now I don't want to - you, you, if you would, go to work on it and call me back?
B: I've got your problem, Henry, and I'll go right at it.
HMjr: Because, here's the way I feel, as problem number one, - Are our estimates of revenue correct?
B: Right
HMjr: If we can satisfy ourselves as to that that's fifty per-
B: Right
HMjr: cent of the question.
B: Right
HMjr: Isn't that right?
B: Yes, I think it is.
HMjr: That's fifty percent. The other - other problem, see -? which I may talk to you later over the week-end.
B: Right
HMjr: But if you could do this for me?
B: Well, I've got - I've got some further ideas on that and I'd like to talk on the telephone with you over the week-end about it.
HMjr: I will.
B: Where are you going to be, Hen?
HMjr: Right here.
B: Righto
HMjr: Right
B: All right, you'll hear from me in an hour or two.
HMjr: Thank you.
B: Goodbye.
Friday
May 8, 1936

HMjr: Hello
Earle: Hello, Henry
Bailie: Hello, Earle

B: Henry, I've got the following things to suggest.

HMjr: Please

B: In the first place I'd like to make a very radical suggestion which I think would be excellent policy and a good thing to do.

HMjr: Yes

B: It's not an exclusive suggestion, it's part of a general suggestion so hear me through before you express a view.

HMjr: That's all right.

B: I would send for George May -

HMjr: Yes

B: and I would ask him to come and sit down with me. I'd say to him that you-each of you had only one thing at heart you felt sure and that was the soundness of whatever measure went through and you wanted him to look at your figures and see - point out to you personally where they were wrong if they were wrong.

HMjr: Yes

B: You want to know what the facts were. I think, from the point of view of getting advice you'd be talking to the best man in the country; from the point of view of spiking the enemies' gun, you'd make it almost impossible for him to be an effective weapon from that time on against you.

HMjr: I see.

B: Now, that's a low point of view -

HMjr: Yes

B: But I see it combines several rather attractive features.

HMjr: Yes
B: Now then, I wouldn't see him alone. I would ask down one of the two following persons, Mr. Niven, of Touche Niven -

HMjr: Mr. who?

B: N-i-v-e-n

HMjr: N-i - ?

B: v-e-n

HMjr: Niven?

B: Niven of Touche Niven

HMjr: of Touche

B: Niven

HMjr: Touche Niven, yes

B: Now then, I don't know him personally, but two men whom I - of whom I have the highest regard and who work with accountants constantly, tell me that of the accountants -

HMjr: Yes

B: - in this country, that second to May -

HMjr: Yes

B: - he's the kind of a fellow who stands on his own feet, who would not be overwhelmed by May at all.

HMjr: Yes

B: I mean, if he thought he was right the devil couldn't keep him from saying so.

HMjr: Yes

B: Now if you couldn't get him or if he couldn't for some reason or other sit in - of course I don't know anything about politics or --

HMjr: No, I don't - I don't care.

B: Well, neither did I. I knew you didn't, but I mean I did want to say that. I haven't had time --

HMjr: Yes - is Mr. Niven the head of the firm?
B: Well, I think Mr. Touche has died.

HMjr: Yes

B: Mr. Niven is the active leading man.

HMjr: Yes

B: Now there's - the other man is a fellow named Staub, S-t-a-u-b.

HMjr: Yes

B: Of Lybrand, Ross and Montgomery

HMjr: Of what?

B: Lybrand -

HMjr: Library?

B: L-y-b-r-a-n-d

HMjr: Lybrand?

B: Lybrand, Ross and Montgomery

HMjr: Ross?

B: Yes

HMjr: Yes

B: and Montgomery.

HMjr: Yes

B: Now, both Touche Niven and Lybrand, Ross and Montgomery are A-1, very prominent firms.

HMjr: Yes

B: Their names, to anybody who is a student of that school at all would stand just aces high.

HMjr: Yes

B: So either one of those fellows would be useful but it's only fair to say that I couldn't find anybody who said that George May had any second in his field.

HMjr: Any which?
Any second -

Second?

In other words George May is the first man in his field and he is the second man in his field according to the public opinion.

Yes

Now this - here is the other suggestion that I have to make. There is a man named Frederic Mills, M-i- double l-s, professor at Columbia -

Yes

- who has published over a period of the last three or four years -

Yes

- studies on the sources of income in the United States, from various points of view including the tax point of view, -

Yes

- which are the best things of their kind that have ever been written.

I see.

And he probably knows more about the sources of the income in this country -

Yes

than any other single individual.

I see.

And I think that that fellow -

Yes

I don't know whether you could get him or not -

Yes

But if you could get him - and he told me that a set of figures were right -
HMjr: Yes
B: - from the business point of view, because after all that's - you're just as much interested in that -
HMjr: That's right.
B: I would believe him.
HMjr: Yes
B: I'd absolutely believe him.
HMjr: Yes
B: Now that's about the story, Henry.
HMjr: Well that's very very helpful.
B: I think my, - don't dismiss my May suggestion lightly.
HMjr: Pardon me?
B: I say, don't dismiss my --
HMjr: I - I don't want to sound Rooseveltian, but I did have it in mind.
B: (Laughter) O. K.
HMjr: All right
B: All right, sir
HMjr: All right
B: I know that man well enough to know, -
HMjr: Yes
B: - that he'd never take advantage of you.
HMjr: Yes
B: I mean, he's that kind of a fellow.
HMjr: Well, that's nice, but I take advantage of so easy.
B: I think you could take advantage of him.
HMjr: (Laughter)
B: Right
HMjr: All right
B: All right, I'll be hearing from you over the weekend.
HMjr: Yes, that's right.
B: Goodbye.
HMjr: Goodbye.
* * * *
HMjr: Get me the University of Chicago.
Operator: All right.
Operator: Here you are —

HM Jr.: Hello —

H. M. Cochran: Hello — hello, Mr. Morgenthau —

HM Jr.: Good morning — hello, Cochran —

C: Mr. Morgenthau?

HM Jr.: Yes

C: Do you hear me?

HM Jr.: I hear you.

C: You can hear me?

HM Jr.: Yes

C: The market is a little nervous today —

HM Jr.: Yes

C: The turnover is not nearly so large as yesterday.

HM Jr.: Yes

C: At two forty-five this afternoon Guaranty had done three and one half million dollars.

HM Jr.: Yes

C: The Control is in at seventy-five point sixty-two having — with a little more business done over London —

HM Jr.: Yes

C: for New York.

HM Jr.: Yes

C: But still today it's not nearly so nervous as yesterday.

HM Jr.: Yes

C: The market seems rather bare of francs.

HM Jr.: Bare of francs?

C: That's right. And the big French banks have stepped out of the forward markets.
Yes
So that's the situation a little bit.

Well now, would you say that there was - that it's better or worse?

It looks better today.

Better today?
Yes
Better today?
Beg pardon?
Is the situation better or worse today?
It's better today.
Better today?
Yes - The stock market opened rather badly with the Bank of France shares down and the  down.
Yes
Improving since the opening -
I see.
The situation is not good yet.
Yes
But still it is better than yesterday.
Yes
Considerably better.
All right, now your cables are very helpful.
I departed that visit yesterday morning.
Yes
I was out there at eight-thirty.
Is that right? - Now, Cochran -
C: Yes
HMjr: You needn't send any more cables across the Channel.
C: No?
HMjr: No - you can stop that.
C: Beg pardon?
HMjr: Stop sending any more copies of your cable across the Channel.
C: I see.
HMjr: Do you know what I mean?
C: Yes
HMjr: I mean I make it specific, you needn't send anymore to Butterworth.
C: Beg pardon?
HMjr: You needn't send copies of your cables to Butterworth.
C: I understand.
HMjr: You haven't gotten any more from him, have you?
C: No, I haven't for a while.
HMjr: No, well then you stop sending him cables.
C: I see.
HMjr: Yes
C: And - did you hear about the Parker Willis article in the "Agence Economique" this morning?
HMjr: No
C: I wired it to you in its entirety.
HMjr: What does - what does my friend Parker say this morning?
C: He said that it was generally admitted that an important agreement had been concluded between the British and American authorities - which is due to the present relation of dollar and pound.
HMjr: Wait a minute, say it again.
Really due -

I say, start from the beginning.

Yes - I'll read it verbatim.

Is it very long?

No -

All right

'It is generally admitted that an important agreement has been concluded between British and American authorities which is due to maintaining the present ratio of dollar and pound in face of monetary dangers in Europe.'

Yes

When Mr. Morgenthau as to whether its ratio would permit that any stabilization bond could forego in New York against the dollar sale or eventual export, declared that he did not wish to discuss it. This answer has been interpreted as confirming actual conclusion of an Anglo-American Agreement. According to other information straight from unofficial sources the agreement has already entered into effect.

Yes

'It appeared that the rate for conversion of pound into dollar of about the present level with allowances made for the ratio periodically within the limit of terms outlined by British monetary authority.'

Yes

'The of the American authorities has been attributed by this act as its arrangement conclusion of a stabilization agreement with Great Britain. And yet only a few months ago the creation of such a state of affairs was declared improbable by both parties.

Yes

Treasury high officials of the Treasury some irritation at the Treasury in the matter of monetary policy operates on a twenty-four hour basis.
I think this has attracted quite a bit of attention over here.

HMjr: What's that?
C: This has attracted considerable attention.

HMjr: Well, your comment can be that he's just another professor.
C: (Laughter) Well, I won't make any, but I want you to have the full text -

HMjr: All right - just another professor
C: I see our friend tomorrow -

HMjr: Yes
C: And they meet on Sunday and Monday.

HMjr: Who does?
C: The Bank meets - the B. I. S.

HMjr: Oh, yes.
C: So I'll be back Tuesday morning.

HMjr: All right.
C: And Tannery is going also.

HMjr: Yes
C: And so we expect nothing - no turnover of any kind here this week.

HMjr: I see.
C: Although the Left is urging Sarraut to get out and make way for Blum.

HMjr: Yes
C: But if the situation doesn't get any worse why that's unlikely.

HMjr: Yes. All right, thank you. Good -

C: I'll wire you Tuesday and I'll have my assistant wire you probably Monday.
HMjr: All right -
C: Goodbye
HMjr: Thank you.
May 8, 1938

Meeting held in Secretary Morgenthau's office at 10:30 on Housing

Present: Secretary Morgenthau,
Jesse Jones
James B. Alley, General Counsel RFC
Mr. Bell
Mr. Oppen

Mr. Jones: Read off items one and two.

Mr. Jones: No. 3 provides the right to borrow from the RFC 100 million without security.

Mr. Jones: No. 4 - Right to issue notes guaranteed by the government for the next three years.

Mr. Jones read on and after he had read the sentence, "the grants may be in the form of annual subsidies" he said, "that may be any direct grant."

Mr. Morgenthau: Have you some ideas about it.

Mr. Jones: Have a good many ideas about it but it is hard to take the bill and show what it will do.

Mr. Morgenthau: Let's take it from the money standpoint. He said between 8 and 9 million.

Mr. Bell: What is that for?

Mr. Jones: I don't know.

Mr. Morgenthau: He had a direct appropriation of 51 million.

Mr. Bell: That is right.

Mr. Jones: I have not been able to find out from Colonel Hackett or Colas or get an estimate of what they thought they could spend or should spend within a fiscal year but that 9 million was really to pay that extra rent - the subsidy.
Mr. Bell: The money made available for the grant over and above —

Mr. Jones: Yes — instead of giving them 45% we will let them pay their rent.

Mr. Opper: It was to give them everything over $6.00 rent for 45% of the balance - 45% of the $6.00.

Mr. Morgenthau: You mean 45% of the $6.00?

Mr. Opper: That's right. I got that through Oliphant.

Mr. Morgenthau: Let's say the building costs 1 million. As I understand it the New York Housing Authority builds a building for 1 million and I understood it that $550,000 is raised in the State of New York and that $450,000 will be loaned by the federal government and then the fellows pay less so the rooms are worth $10.00. The tenant pays $6.00 and the federal government pays $4.00 - is that wrong? Is that the way it is in the bill?

Mr. Opper: In the bill it is different again. Regardless of what the cost of the project is as compared to the rentals they can get they can grant up to 45% of the total cost.

Mr. Morgenthau: Is it true that we can only lend money to the State Housing Authority?

Mr. Opper: You can lend it to a Mortgage Dividend Company under the bill.

Mr. Morgenthau: Well don't they raise any money?

Mr. Jones: No requirements on this bill.

Mr. Opper: Can I give you the pattern of the present bill. The Housing Authority, under the Wagner Bill, can grant 45% of the total cost regardless of how much is received in rent. They give them 45% and never get it back and they can rent all of the rest. In the case of a Limited Dividend Company they can't make any grant but can lend up to 95% of the cost. The rent stuff was injected for the first time in the new proposal - not in the bill.

Mr. Morgenthau: Isn't that in the bill?

Mr. Opper: That is with respect to the amount of money that the government will give.
Mr. Alley: This grant may be in a lump sum or may be in fixed contributions over a period of 60 years.

Mr. Oppen: You start out with a grant - you can either give 45% in a lump sum or capitalize it on an annuity basis and pay off 1/60th each year but total amount is only 60%.

Mr. Morgenthau: My father made money out of real estate and so did Jesse.

Mr. Jones: Yes I made money and lost too.

Mr. Morgenthau: Give them the $450,000 and get through with it.

Mr. Jones: That's all right, Henry, except you don't get ---

Mr. Morgenthau: I know but if you give them that then you are through because at the end of the 50th year we would have to build.

Mr. Jones: You are never going to get through as long as you have Congress. If you give them 45 this year you will have to give them part of the 55 next year. I want to explain this. If that room ought to rent for $10. in order to pay 85% on the investment and a fellow can't pay this we have to give him this $4.00 some way. You will give him the 450 but the only grant to pay is rent. You don't do both - you do one or the other.

Bell: Section 9 provides for a grant.

Mr. Morgenthau: Let's think out loud for a moment. Up to now we have taken the position, unless something happened last night, that anything that is not in the budget is out.

Mr. Jones: This is not in the budget - is it no part of it?

Mr. Bell: No part of it.

Mr. Morgenthau: Now what will it do then? That seems to be in the President's mind that you have to have some grant. I think he said they are asking for 51 million but they are not going to spend it but hell it shows up. If you give them 51 they spend 52.
Mr. Jones: But Wagner - I think you have to find some way to give him some grant for the first year.

Mr. Morgenthau: I have a radical suggestion to make. Everybody admits that the housing that Ickes has done is nothing but slum clearance - is that right Jesse?

Mr. Jones: That is right.

Mr. Morgenthau: The suggestion I will make is that if I take this bill I would have to take anything Ickes has planted in his low cost housing organization - so many millions of dollars.

Mr. Bell: I don't know how much - 170 or 140 million - some is obligated and some spent but very little has been spent.

Mr. Morgenthau: Why don't we say to this organization - stop this building of low cost housing. Low cost housing does compete with private capital and let's do what we all talked about - make Ickes' organization into a real slum clearance organization and change the rules and regulations so that it is really a slum clearance organization.

Mr. Jones: At first blush that sounds good. That would get over your immediate grants but you have a good many hurdles to go over with Wagner. I think you can get your first money out of this business here - this 140 million but I think you would have a hard time to satisfy Wagner with just that.

Mr. Bell: What chance has this bill - you only have a month of Congress left.

Mr. Morgenthau: I am not going to say you don't need slum clearance but I am going to say the money is there.

Mr. Jones: I have been talking along that line with Hackett. You go to Atlanta and build a nice building. Congress is thinking about slums of New York, Pittsburgh, Chicago. You don't need it in St. Louis, Dallas, etc.

Mr. Jones: I am not going to get into an argument but how much has Ickes got left? Could you give us some idea as to how much of this 140 is available and so on and then I will work out a program and come back here Monday or Tuesday.

Mr. Morgenthau: Are we thinking alike?

Mr. Jones: Yes absolutely.
Mr. Bell: It is the same old story you will run up against - only 30 or 40 million actually obligated. It is all committed and they may have gone out and let contracts for the foundation. We will say they have not let contracts for the foundation so to that extent the money is committed but it is not actually obligated.

Mr. Morgenthau: What is the total sum he has for low cost housing?

Mr. Bell: He had a little over 100 million.

Mr. Morgenthau: Oppen was in this low cost housing in New York - he knows all about it.

Note: While Mr. Morgenthau was telling Mr. Jones that Oppen knew all about this low cost housing, Bell was checking his book for the total sum which Ickes had for low cost housing.

Mr. Bell: 101 million allocated out of the 4 billion by the President for housing. 27 million of that is obligated and 13 million 800 thousand has been spent.

Mr. Morgenthau: Yes but Dan back of that was the old 3 billion 3.

Mr. Alley: What date is that?

Mr. Bell: April 20th.

Mr. Jones: I think we can check this thing and work out a plan and I will get it back here. There is no hurry as Wagner left for New York and won't be back until after Monday or Tuesday.
WAGNER BILL

Capital Funds

1. Transfer of property now belonging to FHA of the approximate value of $140,000,000.

2. Federal appropriation of $51,000,000 for the first year
   $75,000,000 for the second year
   $100,000,000 for the third year
   $100,000,000 for the fourth year.

3. Right to borrow from the RFC $100,000,000.

4. Right to issue notes guaranteed by the U. S. Government,
   $100,000,000 for the first year
   $150,000,000 each for the next three years

Bill provides for a Board of 5.

No limitation placed on type of demonstration projects to be wholly financed by Federal Government.

Authority is authorized to make grants up to 45% of the cost of land and buildings to public housing agencies, and may loan to limited dividend corporations up to 85% of the cost of land and buildings, to the amount of $25,000,000 per year for four years.

The grants may be in the form of annual subsidies
Loans may be made for as long as 60 years.
INDEX

NEW ORLEANS CASES
May 9, 1938

Memo from Irey, attaching report from Special Agent in Charge Buford, advising of disposition of five cases in New Orleans.

May 19

Memo from Irey reporting further on disposition of New Orleans cases.

May 20

Memo from Irey and attached report from Burford. Irey says Jackson trying to arrange conference to discuss the handling of New Orleans cases.

May 22

HM, Jr. called Bob Jackson to raise question with him, officially, as to whether or not Viosca was fit to try the New Orleans cases.

May 23

HM, Jr. spoke to Attorney General about Viosca and inquired of him if he was not disturbed. Attorney General said no; nothing to get really disturbed about.

June 1

HM, Jr. spoke to the President; told him Viosca's name was going to be recommended for District Attorney of New Orleans and that under no circumstances should his name be sent up for confirmation.

August 10

Letter prepared by Gaston to Editor, NY Herald-Tribune contradicting information contained in their editorial of August 8.

August 11

At lunch with Atty. Genl., HM, Jr. said he thought it would be mutually advantageous to have Bob Jackson try the Louisiana tax cases. Jackson's secretary said he did not want to, but Cummings will personally get in touch with him. Atty. Genl. advised against sending letter to NY Herald Tribune saying Treasury was "in the clear."
MEMORANDUM FOR THE SECRETARY:

Attached is a communication from Special Agent in Charge Burford at New Orleans, in which he advises that on May 5th Rudy O'Dwyer, George O'Dwyer and C. A. Kenney appeared in court before Judge Rufus E. Foster, senior member of the Circuit Court of Appeals, and entered pleas of guilty to all counts in the indictments against them. They were fined, respectively, $4500, $5500 and $1500 and were required to pay the taxes and penalties charged to be due. The total of these taxes and penalties was $35,401.00, which, together with the $9500 in fines, made a total of $94,901.00.

Last evening I received a telegram from Mr. Burford advising that yesterday afternoon Manasse Karger and Marks Karger appeared before Judge Foster, plead guilty and were fined $1,000 each. They, likewise, were required to pay their taxes and penalties which totaled $20,560.00.

There was, consequently, received from the five defendants in taxes, penalties and fines a total of $115,860.

Of the seven cases now disposed of in New Orleans, one (Joseph Fisher) resulted in conviction and sentence to eighteen months in the Penitentiary; five (those enumerated above) resulted in pleas of guilty; and one (Abe Shasham) resulted in an acquittal, or a total of six cases won out of seven disposed of.

There are remaining in this series of cases indictments against Joseph Hespell (recognized as an anti-Long man); Jules Fisher (a member of the State Legislature and a relative of Joseph Fisher, already convicted); Seymour Weiss, Nick Fernandez, The Hartwig Moss Insurance Agency, which is a conspiracy charge involving Joseph Myers, Seymour Weiss and Mike Moss; the Louisiana Quarry Company, which is a conspiracy charge involving E. S. Wilson, Seymour Weiss, G. D. Nichols and H. S. Schiff; and the Mississippi Valley Company, which is a conspiracy involving

The Louisiana Quarry Company case and the Mississippi Valley Company case are set for trial in June before Judge Borah, and the agents, with the United States Attorney, are busily engaged in preparing these cases for trial.

Mr. Burford tells me on the telephone this morning that there are rumors around that Haspell, Fisher and Fernandez may possibly plead guilty. If this happens and the two cases set for trial in June are disposed of, that will leave one conspiracy case (The Hartwig Moss Insurance Agency) and the individual charge against Seymour Weiss, to be disposed of.
Chief, Intelligence Unit,
Bureau of Internal Revenue,
Washington, D. C.

Dear Mr. Irey:

In re: Rudy O'Dwyer,
George O'Dwyer,
C. A. Kenney.

As related to Mr. Woolf by telephone, the three above-named parties appeared in court and entered pleas of guilty to all accounts in the indictments and were fined as follows:

<table>
<thead>
<tr>
<th>Name</th>
<th>Fine</th>
</tr>
</thead>
<tbody>
<tr>
<td>C. A. Kenney</td>
<td>$1500</td>
</tr>
<tr>
<td>Rudy O'Dwyer</td>
<td>$4500</td>
</tr>
<tr>
<td>George O'Dwyer</td>
<td>$3500</td>
</tr>
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I was advised by United States Attorney Viosca yesterday afternoon, May 5th, and asked to treat the same in confidence, which I did, that he had been advised by Judge Rufus E. Foster, senior member of the 5th Circuit Court of Appeals, that he had been approached as to receiving pleas of guilty from the gamblers. This morning, just prior to ten thirty, I was in communication with Mr. Viosca on another matter, and he advised me that Judge Foster had just sent for him and asked that I come over. Upon my arrival, the Judge had just taken the bench, and former United States Attorney Edmond E. Talbot, who is now occupying the position of Referee in Bankruptcy, and his brother, Harry Talbot, counsel for the above-mentioned parties, made the statement that they wished to withdraw their former pleas of not guilty and enter pleas of guilty to the respective indictments.
The United States Attorney asked the Court if he desired to hear evidence from the agents as to the facts, and he stated that he did not care to hear such evidence either from the agents or the United States Attorney, and that the indictments spoke for themselves. He then said to counsel that he preferred not to consider sentence until he knew what disposition they proposed to make of the "unpaid taxes" (this was his exact language) referred to in the indictments. He made other references to the charges as failure to pay their taxes.

The Court's attention was then called by the United States Attorney to the fact that in addition to the taxes where fraud was alleged, a civil evasion penalty of 50% was applicable. The Court then stated that that amount should be added to the tax as shown in the indictment, and that those sums should be placed with the clerk of the court for the account of the Collector of Internal Revenue in the form of certified checks, and that if such was done he had in mind the imposition of fines. The court was then adjourned for a few minutes to afford the defendants an opportunity to carry out the Judge's expressed wishes. When this was done, he imposed the sentences above related and committed the defendants to the custody of the Marshal pending the payments of the fines, which were immediately accomplished.

It has been the practice on occasions, so I am informed, for Judge Foster to hear pleas of guilty during the absence of Judge Borah, who is at present away on his wedding trip, and I am informed that a day or two prior to Judge Borah's departure, at a conference between the United States Attorney, Judge Borah and Judge Foster, Judge Foster had stated that he would take care of pleas during Judge Borah's absence.

It was observed by one of our employees on May 4th that Attorney Talbot was in conference with Judge Foster, and we also know that Judge Robert Rivarde, Judge of the 24th Judicial District of the State of Louisiana, was in conference with Judge Foster prior to the entering of the pleas. Judge Rivarde was referred to by others under investigation sometime ago as having advised them to file amended returns when the investigations were instituted. His district includes Jefferson Parish,
where the O'Dwyers operate their gambling institutions, and he is known to be on good terms with them. Upon leaving the Court, after sentence was imposed, he waved his hand to Judge Foster, who was then on the bench, and very affably said "good bye."

Judge Foster stated in connection with the certified checks which were placed with the clerk of the court that it was to be understood that the payment of this amount of money was not to prejudice the taxpayer's rights to secure an abatement, or refund, of the taxes, or the Government's right to assert additional taxes, interest and penalties, in appropriate civil actions. This, of course, was most unusual, and I suggested to the Assistant United States Attorneys handling the matter (the United States Attorney had to leave to take care of private litigation in the State Courts) that it might be well to discuss that provision with the Court as it was not making a clean cut issue of the payment of the taxes and was likely to be the basis for unnecessary civil litigation, but in view of the Court's stated attitude, they were not inclined to make any mention of it to him, and did not do so. He stated that judgment should be prepared accordingly, and there are attached hereto copies of the receipts given to the defendants in exchange for these payments, which incorporate that provision, so far as the defendants are concerned.

Personally, and without insinuations to anyone, I have the private opinion that the action which took place today was in the making sometime ago.

As an interesting side light, Herman B. Deutsch, a feature writer for the "Item-Tribune", told me that during the adjournment while the Court was awaiting the return of the defendants, with their certified checks, Kenney approached him with a $50 bill in his hand and attempted to get Deutsch to accept it as a fee for not giving him a bad write up. This made Deutsch very furious, but he asked me to treat the matter in strict confidence.

It is not known whether other defendants will appear and enter pleas before Judge Borah's return, but you will be kept advised promptly of any developments.

Respectfully,

A. D. Burford,
Special Agent in Charge.
2 O'DWYER'S GUILTY, FINED
Hold Hunter for Harboring Karpis; Bail $200,000

O'Dwyer Brothers, Their Friend Judge Rivarde

The O'Dwyer brothers smiled broadly Wednesday after they had pleaded guilty in violation of the income tax laws and received a fine at the hands of Federal Judge Rufus E. Foster. In the picture, from left to right are GEORGE O'DWYER, JUDGE L. ROBERT BIVENS of Jefferson parish, and RUDOLPH O'DWYER. (Photograph by the New Orleans States."

2 O'DWYERS, KENNEY PLEAD GUILTY IN U.S. TAX CASES, PAY FINES

Ralph and George L. O'Dwyer, Jefferson parish gas dealers, and Courtenay A. Kenney, St. Tammany parish gas dealer, charged with evasion of income taxes for the year 1936, both appeared before Federal Judge Rufus E. Foster Wednesday morning and pleaded guilty to the charges. The plea of guilty came as a complete surprise at the trial of Kenney who recently been convicted because of the absence of Federal Judge Charles G. Smith, who is on his sick leave. Judge Foster, a member of the circuit court of appeals, announced that the plea of guilty would be accepted as payment of the taxes owed. The court ordered the payment of the taxes to the government, plus interest and costs. I don't believe in sending men to jail when they plead guilty unless it is absolutely necessary, and Judge Foster. I would be disposed to impose fines rather than sentences.

What Must Next Pay
Emanuel H. Tobert, attorney for the three men, was instructed by Judge Foster to obtain certified copy for the amount due the government and present them in court. The munificence was $11,579.44 for Ralph O'Dwyer. $11,579.44 for George L. O'Dwyer, and $11,579.44 for Courtenay A. Kenney. Ralph O'Dwyer was fined $250, his brother, George, $250 and Courtenay A. Kenney $250. The taxes were paid with certain
O'DWYERS, KENNEY 'GUILTY,' ARE FINED

Pay Full Levies Demanded by U. S., Plus 50 Per Cent Penalty

Continued from Fly Sheet

checks and the fines with personal checks by the men.

There was a spirit of levy prevalent throughout the pleading of guilty by the three men.

When the offer of a plea of guilty was made by Mr. Talbot to Judge Foster he was told to "go out and draw certified checks and I will impose sentence."

"These cases could have been compromised after indictment," added Judge Foster. "Are you prepared to make payment?"

"Yes, sir, we can give bona fide checks right now," replied Mr. Talbot.

"Yes, but you could stop payment on those checks, though I don't say you would," replied Judge Foster.

"Oh, you get those checks certified and come back here. I will be here all day because I have to remain in court."

Mr. Talbot, accompanied by his clients, immediately left the building to have the checks certified and returned a short time later.

Karger Brothers Cases End

The checks are made payable to the order of the court and will be deposited in the registry of the court and held for the collector of internal revenue for the eastern district of Louisiana.

"Am I to understand that we still reserve our civil rights?" asked Mr. Talbot.

"Certainly, you could never waive that right," replied Judge Foster.

The O'Dwyers and Kenney were indicted some time ago on charges of attempting to evade payment of income tax. Marx and Manasse Karger, also Jefferson parish gamblers, who at one time were partners of the O'Dwyers, are also under indictment on similar charges.
Baton Rouge Bridge Case

O’Dwyers, Kenney Plead Guilty; Fined
Gamblers Freed In Tax Fraud

Three Pay U. S. On Evaded Levy

Courtney A. Kenney, operator of the Arabi club in St. Bernard parish and Rudy and George O'Dwyer, of the Original Southport Inn, all prominent New Orleans gamblers pleaded guilty before Federal Judge Rufus E. Foster today, agreed to pay the government their delinquent income taxes plus all penalties and were assured of no jail sentences by the court.

Kenney was the first to pay off his debt to the government, and stood before the bench awaiting sentence. "We don't want to put this on a percentage basis, Mr. Kenney," said Judge Foster, a twinkle in his eye. "I guess $1,500 will be enough. That's the fine." George O'Dwyer who next presented his certified check to the court received a fine of $2,500. His partner, Rudy, followed and was fined $4,500.

All the fines were paid, and the three walked out of court free of charges.

Foster Hears Pleas

The three gamblers were represented by Edmond E. Talbot, referee in bankruptcy and former U. S. Attorney here. Judge Foster heard the plea in the absence of District Atty. Wayne O. Borah who is on his honeymoon.

When the pleas had been entered, Judge Foster said:

These cases could have been dismissed even after an indictment. I do not believe in jail sentences in tax cases where the amount sought by the government actually paid to the collector.

A Laugh Brought Out

Talbot then announced that the three were ready to turn over their certified checks to the registry of court for the taxes owed plus penalties, pointing out at the time that each defendant was given in credit for sums paid to

(Continued on Next Page)
Gamblers Plead, Fined And Freed

(Continued from Page One)

the collector since the investigation began.

"Well," drawled the court, "you could stop payment on checks, you know; but then I guess you wouldn't do that."

In the laughter that followed he added: "Go ahead and get the checks certified. Make them payable to Rufus W. Fontenot and then we'll talk about sentences."

What They Are Paying

With the penalties included each of the three defendants paid in addition to the fines:

Kenney—$10,117.78
Rudy O'Dwyer—$42,741.92
George O'Dwyer—$22,501.29

Kenney was indicted in November, 1934, the true bill charging evasion of $8,076.84 in income taxes during 1929, 1930 and 1931; that he concealed an income amounting to approximately $80,000. He operated the Arabi club for 15 or 18 years and was in charge of the club at the time the late Huey P. Long made his sensational gambling raids in St. Bernard parish. Among gambling patrons he has many warm friends who vouch for him as being "on the square."

The O'Dwyer brothers were indicted last February, the true bill being returned on the same day that the indictment charging Massey and Marks Karger with income tax evasion was handed down. Rudy O'Dwyer was charged with evading payment of a tax of $29,260.07 on an alleged gross income of $233,325.17 and his brother, George, with evading payment of $22,533.32 in income taxes on a gross income of $204,918.78 for 1929, 1930 and 1931.

The O'Dwyers were associated with the Kargers in the operation of Club Forest in Jefferson parish, and for years before Club Forest opened, operated the Original Southport Inn.

Father Goes To See Son
First Time In 40 Years
(By The Associated Press)

RONAN, Mont., May 6.—A Mr. Noble arrived from Sac City, Iowa, and immediately asked the postmaster if he knew a Ronan citizen named R. C. Noble. The postmaster did, and would take him to his home.

When he saw the Iowa visitor R. C. Noble exclaimed: "Why, dad, where did you come from?"

It was their first meeting in 40 years.

British Red Cross
Leader Dies Of Wounds
(By The Associated Press)

LONDON, May 6.—Dr. A. J. Molly, leader of the British ambulance unit in Ethiopia, who was wounded Sunday during native riots in Addis Ababa, died last night in the British legation, his relatives were informed officially today.

Dr. Molly was shot in the lungs Sunday afternoon while dragging wounded in from the streets.