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PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: May 11, 1936, 10 a.m.

NO.: 386 FROM COCHRAN.

On Saturday, in the afternoon, I went to Badenweiler to visit Schacht.

Schacht told me that as for his own position, he was going on with it as before, saying that I should know him sufficiently well by now to understand that he would not carry on in a position if it were not definite that he was the one in command. The publicity which the appointment of Goering had been given was regretted by Schacht. The latter has no intention of making a public statement about it, but he did tell me that it was for him to get some of the people with "prestige" in the German regime "to listen to reason", and that it was a real advantage to him if he could talk to Goering directly, and inform him of the current situation, since he represents the military and the party. Schacht said, when he mentioned this "prestige", that it was used to hide the gateway of internal weaknesses which have a truly economic bearing; the country could not admit that the German Government did not know whether it was able to guarantee food and work to its people. Such an admission would show weakness, and tremendous difficulties might result

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result therefrom.

The German Government has undertaken the rearmament program, giving as an excuse for it the necessity of upholding German prestige. Through this program it has been able to give employment to idle industries and laborers. Limitation of imports in keeping with the purchasing power of the country has entailed hardships which, however, have been borne by the people after being told that such limited imports were essential to the defense of their national existence.

My contact insisted that the factors which lead to war are maldistribution throughout the world of economic privileges and resources and the existence of trade barriers which prove to be insurmountable. He contends that such countries as Japan, Italy, and Germany would not be using force as a means of righting such situations if it could be hoped that it could be done in a peaceful manner. It is Schacht's opinion that the affair in the Rhineland is closed. He said that one of the last steps toward achieving "prestige" was this rearming of the Rhineland.

Schacht insists, though, that internationally there must be greater economic liberty before Germany can recover. He gave me his promise that he would give me

excerpts

Memorandum of Facts - 3 - of No. 122 of May 11, 1934,
from the American Embassy, Paris.

excerpts from an official German note which has just
been addressed to the Swiss Government. He contends
that this note shows positively that the method of bal-
ancing trade and payments bilaterally has not been looked
on with favor by the German Government, and that the
latter is now most anxious to extricate itself from the
system which was forced upon it.

During the course of the conversation I made men-
tion of the fact that the United States had consummated
a trade agreement with France. I expressed the hope
that understandings with other major powers might now
be brought about.

END FIRST SECTION.

STRAUS.

...with respect to Germany, as
had made use of every device that he knew about to
postpone definite German devaluation until he could
discuss the matter with other countries. He did not
want to establish a fixed value for the Reichsmark
in view of the uncertain conditions which have been
prevailing with regard to sterling, the gold bloc, and
so on. He expressed the opinion that the gold bloc
crisis

EA:LWW

10

Paraphrase of Section two of No. 386 of May 11, 1936,
from the American Embassy, Paris.

He then told me that he was very shortly going to talk to the British regarding their restrictions on trade with Germany, - and that his being able to move either way in establishing a final value for the reichsmark was an argument that had weight with the British. He expects that France and other gold bloc countries which have not yet devalued will soon have to depart from the present parities.

With regard to the foregoing, Schacht is especially anxious that France should avoid placing restrictions on exchange, and he said that devaluation is not prevented by placing an embargo on gold nor by the use of exchange restrictions, that it merely postponed devaluation.

Schacht told me that with respect to Germany, he had made use of every means that he knew about to postpone definite German devaluation until he could discuss the matter with other countries. He has not wanted to establish a final value for the reichsmark in view of the uncertain conditions which have been prevailing with regard to sterling, the gold bloc, and so on. He expressed the opinion that the gold bloc
crisis

10 crisis is so far advanced that by July it should be possible to hold such international conversations.

10 My contact told me that German officials in the United States had informed him that the United States had dropped any idea of imposing countervailing duties on goods coming from Germany; he expressed hope that this was true. He said that the small amount of German-American trade that still exists would be completely wiped out by such a measure.

10 At Basel there are current various versions of the Schacht-Goering affair. I shall submit those in a later telegram. It seems that the consensus of opinion is that Schacht will continue in office, and he will have the friendship and confidence of Hitler, as he had heretofore. It is also believed that Goering will actually serve as a shield for Schacht against the military and party. Goebbells, Schacht's enemy, framed the communique which announced the appointment of Goering, but it is not felt that such injury as Schacht may have received thereby will impair his usefulness to Germany. Hitler still realizes what Schacht can do, as does the mass of the serious and conservative populace. Schacht was made
head

head of the Ministry of Economics in order that he could defend the interest of the Reichsbank and the currency. In the same manner, this present division, whether it becomes actual or is nominal only, of authority as regards imports and exchange may be a means of distributing burdens and warding off attacks so as to make it possible for Schacht to attain success in his effort to avoid devaluation until there is clarification of certain foreign monetary positions. Then Schacht would be in a position to bargain with the foreign governments.

END OF MESSAGE.

STRAUS.

EA:LWW

May 11, 1936

The President saw the French Ambassador who is leaving tomorrow for France. He talked stabilization with him and gave Labouleye a definite hint that the French should embargo gold in order that the British would have to come to us and that if they did so, we would drive a bargain with them which would take care of the French interests.

He also said to the President, "I want to talk to you about the tax bill. I have come to some decisions and so very careful study over the week-end and I must discuss it with you. I think it is interesting to note that Byrd dated his letter May 8, the envelope in which the letter was mailed is marked 9 p.m., May 9 and we received it in the office at 9:14 late morning." The President said he thought Mr. Jv. ought to write Byrd a letter and call it to his attention.

May 11, 1938

HM, Jr. called the President at 9:20. He said, "The Bank of France over-colored the news that they gave us last night. Things are much quieter. They must have again given the speculators a squeeze. The pound dropped from 4.99 to 4.96-11/16 and the franc was up for a while to .0659 $\frac{1}{2}$. I am sorry that Blum does not go in before June 2, because that is the day we announce our June 15 financing. I think it would be a mistake to make the announcement the day that Blum goes in. I might, therefore, advance it."

He also said to the President, "I want to talk to you about the tax bill. I have come to some decisions due to very careful study over the week-end and I must discuss it with you. I think it is interesting to note that Byrd dated his letter May 8, the envelope in which the letter was mailed is marked 5 p.m., May 9 and we received it in the office at 9:14 this morning." The President said he thought HM, Jr. ought to write Byrd a letter and call it to his attention.

May 11, 1938

General Hines' assistant called Bell and told him that Farley is trying to get 15 minutes on the air to tell what he is doing for the veterans and the Veterans Administration also wanted some time on the air. The broadcasting companies have agreed to set aside half an hour on Saturday night, May 16, to give all an opportunity to speak. The call to Bell was to ask how much time the Treasury wanted on the program. HM, Jr. discussed it with Gaston and decided that the Treasury will not go on the air at all.

My dear Mr. Secretary:

In my recent letter to you I asked for the names of all corporations which, for the last year for which you have the statistics, had a net income (before Federal taxes) of more than \$1,000,000 and which would have received a tax reduction of 50 per centum of dividends and the pending Bill had in force. Perhaps I did not make it clear that I wished you to assume that the ratio of dividends to net income (before Federal taxes) remained unchanged, and that all the dividends were "taxable". It is possible, of course, that had the pending Bill been in force, many, if not all, the corporations would have paid larger taxable dividends and thus would have further reduced their Federal income tax; but I want you to trouble you to deal with that problem.

Although I assume that it is not necessary, I might point out to you that the statistics I used in my letter, for purposes of illustration, were based upon the assumption that the net income, after Federal taxes, of each of the corporations cited, was substantially equivalent to the "adjusted net income" as that term is defined in the pending Bill, and that all the dividends were "taxable". You appreciate that this statistic was not available to us showing the exact amount of Federal income taxes actually paid or due for the year, but is the income shown on the dividends. I ask this clear to avoid any possible misunderstanding that might arise from the use of the ratio of dividends to net income after tax to compute the effect of the Bill, whereas, realistically, of course, as suggested in my letter to you, the ratio would be that of dividends to net income before Federal income tax.

I want again to express to you in thanks my appreciation of your cordiality and cooperation.

Very truly yours,

Wm. J. Quinn

May 8, 1936

5

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United States Senate

COMMITTEE ON FINANCE

MELVIN M. JOHNSON, CLERK

May 11, 1936.

Honorable Henry Morgenthau, Jr.,
 Secretary of the Treasury,
 Washington, D. C.

My dear Mr. Secretary:

In my recent letter to you I asked for the names of all corporations which, for the last year for which you have the statistics, had a net income (before Federal taxes) of more than \$1,000,000 and which would have received a tax reduction of 50 per centum or more had the pending Bill been in force. Perhaps I did not make it clear that I wished you to assume that the ratio of dividends to net income (before Federal taxes) remained unchanged, and that all the dividends were "taxable". It is possible, of course, that had the pending Bill been in force, many, if not all, the corporations would have paid larger taxable dividends and thus would have further reduced their Federal income tax; but I shall not trouble you to deal with that problem.

Although I assume that it is not necessary, I might point out to you that the statistics I used in my letter, for purposes of illustration, were based upon the assumptions that the net income, after Federal taxes, of each of the corporations cited, was substantially equivalent to its "adjusted net income" as that term is defined in the pending Bill, and that all the dividends were "taxable". You appreciate that statistics are not available to me showing the exact amount of Federal income taxes actually paid or due for the year, nor is the taxable status of the dividends. I make this clear to avoid any possible misunderstanding that might arise from the use of the ratio of dividends to net income after tax to compute the rates of tax I used, whereas realistically, of course, as suggested in my letter to you, the ratio should be that of dividends to net income before Federal income tax.

I again wish to express to you in advance my appreciation of your assistance and cooperation.

Very truly yours,

Henry J. P...

May 11, 1936.

Honorable Harry Flood Byrd,
United States Senate.

My dear Senator:

This will acknowledge receipt of your letter, dated May 8th, which was postmarked as of 5:00 P.M. on May 8th and received in my office at 9:14 A.M. today.

In your letter you furnish a list of corporations with the amount of their net income and the amount of their dividends paid out in 1934, as reported in Moody's Manual, and you ask that I check this list and let you have a similar list for 1935 if such statistics are available. You request also the names of all corporations which, for the last year for which statistics are available, have a net income before Federal taxes of more than a million dollars and, based upon the actual distribution for the year, will receive a tax reduction of fifty per cent or more under the pending bill.

If the information you desire is that to be derived from income tax returns, I must respectfully call your attention to the provisions of the revenue law limiting the conditions under which the Treasury Department may furnish such information. Section 257-b of the Revenue Act of 1926, reads as follows:

"The Secretary and any officer or employee of the Treasury Department, upon request from the Committee on Ways and Means of the House of Representatives, the Committee on Finance of the Senate, or a select committee of the Senate or House specially authorized to investigate returns by a resolution of the Senate or House, or a joint committee so authorized by concurrent resolution, shall furnish such committee sitting in executive session with any data of any character contained in or shown by any return."

I shall be quite willing, on request of the Finance Committee and under the authorization of this section, to furnish any and all

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information that the Committee may desire, which is available. Anticipating such a request, I have directed that data bearing on your inquiries be assembled without delay.

Sincerely yours,

Henry Morgenthau, Jr

Secretary of the Treasury.

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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 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.

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A FEW OF THE CORPORATIONS WHICH WOULD
PAY NO TAX, BASED ON 1934 RETURNS.
 (Now Pay 15%).

| Company | Net Income After Tax | Dividends Paid Out. |
|----------------------------|-------------------------|------------------------|
| American Tel. & Tel. | \$121,748,729 | \$167,960,475 |
| American Tobacco Co. | 24,084,280 | 26,590,858 |
| Amer. Smelting & Refining | 7,583,202 | 7,875,000 |
| General Electric Co. | 19,726,044 | 19,881,453 |
| Goodyear Tire & Rubber Co. | 4,287,684 | 4,508,907 |
| International Harvester | 3,948,637 | 8,264,040 |
| Natl. Biscuit Co. | 11,597,573 | 19,939,342 |
| Natl. Dairy Products Co. | 6,551,930 | 8,197,573 |
| Ohio Oil Co. | 5,411,924 | 6,294,728 |
| R.J.Reynolds Tobacco Co. | 21,536,894 | 30,000,000 |
| Texas Company | 5,545,205 | 9,348,820 |

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.

| | | | Tax under New Bill. |
|-----------------------------|------------|------------|------------------------|
| Air Reduction | 4,145,416 | 3,737,142 | 2.82% |
| Allied Chemical & Dye Corp. | 17,548,355 | 15,703,374 | 3.00 |
| Corn Products Refining Co. | 9,702,696 | 9,294,750 | 1.20 |
| Curtis Publishing Co. | 5,906,326 | 5,400,000 | 2.45 |
| E. I. du Pont | 46,701,465 | 40,788,914 | 3.50 |
| Firestone Tire & Rubber | 4,154,656 | 3,572,193 | 4.00 |
| General Foods | 11,143,876 | 9,452,614 | 4.40 |
| Great Western Sugar | 5,761,727 | 5,370,000 | 1.55 |
| Imperial Oil Co. | 14,101,561 | 13,415,169 | 1.40 |
| Liggett & Myers Tob.Co. | 20,086,691 | 17,200,227 | 4.16 |
| Parke, Davis & Co. | 8,719,368 | 8,232,480 | 1.50 |
| Pennsylvania Railroad Co. | 13,377,839 | 13,214,946 | .30 |
| U. S. Smelting & Refining | 6,052,968 | 6,000,129 | .25 |

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CORPORATIONS WHICH WOULD PAY
LESS THAN 10 PER CENT

| Company | Net Income After Tax. | Dividends Paid Out. | Tax Percentage Applicable |
|-------------------------|--------------------------|------------------------|------------------------------|
| American Can Co. | \$19,522,945 | \$15,256,321 | 6.63% |
| Armour and Co. (Del.) | 8,235,835 | 5,899,830 | 8.84 |
| Eastman Kodak Co. | 14,503,247 | 10,499,086 | 8.54 |
| General Motors | 94,769,131 | 73,621,710 | 6.78 |
| Great A. & P. Tea Co. | 20,478,190 | 16,430,796 | 5.72 |
| International Shoe Co. | 8,967,024 | 6,671,742 | 7.78 |
| J. C. Penny Company | 16,147,315 | 11,307,108 | 9.37 |
| Phillips Petroleum Co. | 5,757,309 | 4,153,008 | 8.30 |
| Proctor & Gamble | 14,370,067 | 10,512,866 | 8.30 |
| Secony-Vacuum Oil Co. | 24,121,297 | 18,652,561 | 6.90 |
| Stand.Oil Co. (Calif.) | 18,347,807 | 13,069,479 | 8.95 |
| Standard Oil Co. (Ind.) | 18,949,680 | 15,371,229 | 5.63 |
| Standard Oil Co.(N. J.) | 67,882,271 | 54,204,193 | 6.08 |
| Texas Gulf Sulphur Co. | 6,958,476 | 5,730,000 | 5.22 |
| United Fruit Co. | 12,049,300 | 8,717,985 | 8.60 |
| F. W. Woolworth Co. | 32,142,363 | 23,288,676 | 8.54 |

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,

Harry J. Pomeroy

United States Senate

COMMITTEE ON FINANCE

FREE



Honorable Henry Morgenthau,
Secretary of the Treasury,
Washington, D. C.

Regraded Unclassified

TREASURY DEPARTMENT

OFFICE OF COMMISSIONER OF INTERNAL REVENUE

WASHINGTON, D. C.

OFFICIAL BUSINESS

PENALTY FOR PRIVATE USE TO AVOID
PAYMENT OF POSTAGE, \$300

Mr. H. E. Gaston,

Assistant to the Secretary,

Room 289 $\frac{1}{2}$,

Treasury Building.

PERSONAL

Regraded Unclassified

The following met with the Secretary in his office at 4:30 this morning: Mr. Mergenthaler, Mr. Vassar, Mr. Bell, Mr. Viner, Mr. Hoad, Mr. Blumenthal, Mr. McLaughlin, Mr. Taylor, Mr. DeLoach and Mr. O'Connell.

The Secretary addressed the group and said, "I would like to state at the start that these matters are confidential, and this morning it is highly confidential."

"I think it is interesting to note that Senator Byrd's answer is dated Friday, May 5. It was postmarked Philadelphia at 5 P.M., and received this morning at 9:14."

Turning to Mr. Johnson, he said, "However, I would like you to write a letter to Byrd, politely bringing his attention to the fact that his letter arrived this morning and that we will give the information for him as soon as it is humanly possible. Byrd's statement in his press statement which he received this letter."

Byrd Letter on Tax Bill

WASHINGTON, May 10.—Senator Byrd's letter to Secretary Mergenthaler, concerning the prospects of the pending tax bill, follows: May 4, 1933.

Honorable Henry Mergenthaler Jr., Secretary of the Treasury, Washington, D. C.

My dear Mr. Secretary:

It has been stated that many of our financially straggling corporations, especially those of substantial size, will pay little or no taxes to the Federal Treasury if the pending bill is passed. I am trusting the accuracy of these statements, and I am therefore interested in the suggestions you may be afforded with respect to the bill to avoid the loss of taxes.

We must guard carefully against giving these large corporations a similar advantage and perhaps a strengthened case their present weaker competitors. Finally, I am concerned about the application of the proposed law to those corporations which now have large surpluses and a strong case in equity position.

We must make certain that legislation does not prevent the healthy growth and expansion of our various businesses by imposing a penalty upon those of 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 received from Moody's Manual a list 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 list contains 1,000 corporations and for 1932. I should appreciate it very much if you would check the list and give your list for me, with a similar list for 1931, if available, as available to you.

A FEW OF THE CORPORATIONS WHICH WOULD PAY NO TAX, BASED ON 1931 RETURNS (List Not In Full)

| Company | 1931 Tax | 1932 Tax |
|----------------------------------|--------------|--------------|
| American Telephone and Telegraph | \$12,748,700 | \$20,000,000 |
| American Tobacco Company | 2,000,000 | 2,000,000 |
| American Woolen and Hat Works | 1,000,000 | 1,000,000 |
| General Electric Company | 2,000,000 | 2,000,000 |
| International Harvester | 2,000,000 | 2,000,000 |
| National Biscuit Company | 1,000,000 | 1,000,000 |
| National Dairy Products Company | 1,000,000 | 1,000,000 |
| Ohio Oil Company | 1,000,000 | 1,000,000 |
| S. I. Reynolds Tobacco Company | 1,000,000 | 1,000,000 |
| Yates Company | 1,000,000 | 1,000,000 |

The above list of financially straggling companies that are completely without taxation has been prepared.

CORPORATIONS WHICH WOULD PAY LESS THAN 2 PER CENT

| Company | 1931 Tax | 1932 Tax |
|---------------------------------------|------------|------------|
| Air Reduction | 4,100,000 | 2,000,000 |
| Allied Chemical and Dye Corporation | 37,500,000 | 10,000,000 |
| Consolidated Paper and Printing | 1,700,000 | 1,000,000 |
| Curtis Publishing Company | 1,000,000 | 1,000,000 |
| C. I. Hooper | 1,000,000 | 1,000,000 |
| Frederick T. Lee and Son | 1,000,000 | 1,000,000 |
| General Foods | 1,000,000 | 1,000,000 |
| Great Western Sugar | 1,000,000 | 1,000,000 |
| International Oil Company | 1,000,000 | 1,000,000 |
| Liggett & Myers Tobacco Co. | 1,000,000 | 1,000,000 |
| Prima, Davis & Co. | 1,000,000 | 1,000,000 |
| Pennsylvania Railroad Company | 1,000,000 | 1,000,000 |
| United States Printing and Publishing | 1,000,000 | 1,000,000 |

CORPORATIONS WHICH WOULD PAY LESS THAN 1 PER CENT

| Company | 1931 Tax | 1932 Tax |
|------------------------------------|------------|------------|
| American Gas Company | 10,000,000 | 10,000,000 |
| American & Co. (Denver) | 1,000,000 | 1,000,000 |
| Atlantic National Company | 1,000,000 | 1,000,000 |
| General Motors | 1,000,000 | 1,000,000 |
| Great Atlantic and Pacific Tea Co. | 1,000,000 | 1,000,000 |
| International Shoe Company | 1,000,000 | 1,000,000 |
| J. C. Penney Company | 1,000,000 | 1,000,000 |
| Phillips Petroleum Company | 1,000,000 | 1,000,000 |
| Pharm & Chemical | 1,000,000 | 1,000,000 |
| Smoky Mountain Oil Company | 1,000,000 | 1,000,000 |
| Standard Oil Company (Indiana) | 1,000,000 | 1,000,000 |
| Standard Oil Company (New Jersey) | 1,000,000 | 1,000,000 |
| Texas Gulf Sulphur Company | 1,000,000 | 1,000,000 |
| United Fruit Company | 1,000,000 | 1,000,000 |
| F. W. Woolworth Company | 1,000,000 | 1,000,000 |

I can tell you further on with the names of all corporations which, in 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 annual distributions for the year, are paying a tax reduction of 25 per cent or more under the pending bill.

The bill appears to be the fundamental purpose of my country involves the use of competitive advantages to the strong corporations, but the measure in every case has small and unimportant advantages upon which we must depend as largely for re-employment of labor and the healthy business growth.

It is necessary 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 attention and cooperation.

Cordially yours,
HARRY F. BYRD.

11 BIG FIRMS LISTED AS PAYING NO TAXES IF NEW BILL PASSES

Byrd Names Them in Letter to Mergenthaler, Asserting There Are Many Others.

WOULD GUARD SMALL MAN

Virginian Fears Corporations Might Get 'Strangled'

While Treasury Buffeted.

Special to The New York Times.

WASHINGTON, May 10.—Senator Byrd, in a letter written to Secretary Mergenthaler of the Treasury and Friday and made public today, named eleven large corporations that, he said, would have paid no taxes at all on their 1931 earnings and dividend distributions if the Revenue Bill now pending in Congress had been in effect.

He explained that he was anxious to show the corporations named for 1931, and to show that Mr. Mergenthaler could assure them that, if the bill of the Senate passed, they would not be strangled.

The bill would permit the firms to show the Treasury the amount of their 1931 earnings and dividend distributions, and to show that they would have paid no taxes at all on their 1931 earnings and dividend distributions if the Revenue Bill had been in effect.

Byrd said the bill would be "greatly improved" if the House bill on the subject were adopted, which he said would have a 10 per cent limit on the basis of 1931 income.

- American Telephone and Telegraph
- American Tobacco Company
- American Woolen and Hat Works
- General Electric Company
- International Harvester
- National Biscuit Company
- National Dairy Products Company
- Ohio Oil Company
- S. I. Reynolds Tobacco Company
- Yates Company

The companies that would have received all their taxes in 1931 were listed in the bill as follows: American Telephone and Telegraph, American Tobacco Company, American Woolen and Hat Works, General Electric Company, International Harvester, National Biscuit Company, National Dairy Products Company, Ohio Oil Company, S. I. Reynolds Tobacco Company, Yates Company.

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"I would like you and Helvering to prepare an answer for me to Byrd and have it on my desk at 12:30. You, Herbert, can write the opening paragraph calling Byrd's attention to the time we received the letter and Helvering can tell him what we can and what we cannot give him so that he cannot begin to say in the halls of the Senate that I am stalling."

Continuing, the Secretary said to the group, "I have done a lot of thinking and studying over the week-end by myself and I have practically come to a decision, but you still have a chance at me before I see the President at one o'clock today.

"As Secretary of the Treasury, as the officer responsible to the President for all fiscal matters, I have come to the decision that I cannot take the risk of giving up something that I have in hand, namely: \$1,132,000,000 in revenue, for a possibility of getting roughly \$1,700,000,000. It seems to me that there are too many dangers surrounding the possibilities.

"The reason we are in this present jam is because the Supreme Court threw out the AAA decision. I do not believe there is a living person who can guarantee that the Supreme Court will not tie up the tax bill immediately after it passes and we will be short all of our revenue. I just think the thing is too great a risk for me to take. The President has left the responsibility entirely on me, which makes it doubly hard. Can you imagine our position if on the passage of this bill we were immediately attacked with injunction suits, etc.?"

"You can ask me why I did not do all this two months ago. My answer is that I was sick and away from the office for two months. I should have had this bright idea two months ago, but I did not. I have it now. I would rather be sorry now than be desperate a year from now. I just feel that the responsibility is too great to take the risk involved and that the only reason we want a tax bill at all is to get revenue to offset these growing expenditures and big deficit, and the only way that we can lick inflation is through a tax bill. But nothing would be worse than if through the Courts our revenue should be tied up.

"I want a frank and open discussion. From a fiscal standpoint, one great fight that we have made here is against

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the printing presses and we did not have to resort to the Thomas amendment. How I will handle myself, I cannot say at the moment. I will think that through afterwards. Am I right that I should not abandon \$1,132,000,000? If that is correct, how do we want to get the additional 625 millions? Am I frightened unnecessarily? I do not know whether the estimates are correct."

Dr. Viner commented that "Even a magician cannot get you a sure answer as to that." Haas' comment was, "I think the estimates are conservative figures. The risk is in the loopholes." Dr. Viner's reply was, "Then the risk is the legal risk."

HM,Jr. said, "As to whether the estimates are correct, Mr. May will be down here tomorrow. I called up Mr. May and told him that I knew his interest was in the success of the bill and asked him to come down to talk to me. Arthur Anderson's partner will be here on Tuesday and Mr. Anderson himself will be down on Thursday. Perhaps Haas' estimates are correct. I am not sure. But I do know that in the minds of the public, serious doubt has been cast on his figures. May's statement has caused grave doubt and that reflects on the whole credit of the Treasury."

Addressing Mr. Helvering, HM,Jr. asked, "Guy, what would you do?" Mr. Helvering answered, "There is a very practical angle to the whole proposition. If we knew this morning that the proposition you suggested is the thing that we are going to follow, then it is one procedure to get the Senate Finance bill reported out to get the revenue. Harrison said he wanted me on the Hill today at ten o'clock." HM,Jr. said, "I talked to Harrison and told him that Oliphant was over-tired and asked him to postpone this thing until Tuesday and he agreed to do so. But that is not important. What I am asking you is, if you were in my chair and the entire responsibility was yours, what would you do?"

At this point, Dr. Viner remarked, "That is an unfair question." Helvering, answering the Secretary's question, said, "My tongue has come up very high in my throat when I think of giving up \$1,132,000,000."

Returning to Viner's remark, HM,Jr. asked him, "Why is it an unfair question?" and Viner replied, "Because he does not know what the legal risks are." HM,Jr. disregarded this

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for the time being and returned to questioning Helvering, asking, "But, Guy, do you mind if I pin you down?" What would you do today?" Helvering answered, "If I were Secretary of the Treasury, I would be pretty scared to give up revenue that I am sure of for the possibility of replacing it by the same amount and a little bit more under the new bill."

Again referring to Dr. Viner's remark, HM, Jr. said to him, "In answer to your statement that Guy does not know what the legal risks are, let Oliphant answer that." And Oliphant's comment was, "The responsibility is yours and of course your decision will be final. Since you have thought it through, there is nothing I can add. I can only speak for myself. I had 13 men for several days analyzing all of the Senate testimony. (A copy of the analysis is attached hereto.) I do not believe anybody has serious doubt as to the constitutionality, so that the only question that has been seriously raised is the question of loopholes." Mr. Morgenthau interrupted to say, "You don't believe that as soon as the bill is passed, they will try to bring suits against us?" Oliphant answered, "May I finish what I was saying? I have gone over it again and again with my men, in whom I have great confidence. The loophole thing is in shape with the exception of two changes as a result of the last minute amendment in the House."

"The Supreme Court -- men like Stone -- have been very much disturbed over the way in which the Federal judges have gone behind in a very peculiar way to interfere with recent legislation. I should think the danger is about the same as the danger that confronted us last year on the inheritance tax. The same thing is true of the tax bill as to injunctions, etc."

HM, Jr., interrupting, said, "Interpreting that into action, what could John W. Davis do to retard our collection of this revenue?" Oliphant replied, "As far as the signposts of the past are concerned, I do not think they can do very much, but, of course, judging by Supreme Court action in the past, there is possibility of an exception."

Mr. Morgenthau remarked, "I have not discussed the 'legal risk' with anybody." Continuing, Mr. Oliphant said, "I do not mean to imply that this set-up is like the AAA. If you asked me is there any possibility of the Federal

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courts running wild, I cannot say that there is no possibility." HM, Jr. inquired, "Does Parker feel the way you do on the chances of injunction? Let me go a step further. I am thinking of the President and his relation to the public. I called up George Haas over the week-end and asked him to work out for me a plan, and have it ready for me by Monday, on the basis that we keep our present tax structure and do not give up anything and take the President's idea of a graduated tax on withheld income. When I gave my ideas to George, he said that he had already started on this very plan. I want to retain the principle of the President's tax message. I do not want to abandon that entirely. I want to move along in that direction."

Oliphant said, "The President starts out in his tax message by saying that he wants to put a stop to the use of personal holding companies and incorporated pocketbooks as a means of tax avoidance. He suggested a plan by which that could be done. Helvering and I, at your instruction, went up and recommended the plan, and so did you."

HM, Jr. told the group, "It is interesting to note that George's plan produces about \$642,000,000. (Copy of the plan is attached.)"

Dr. Viner offered the following suggestion: "Why could you not work out a 5-year plan and write a bill which at the end of five years will put into full effect substantially the present House plan; that is, instead of immediately eliminating the present tax on corporate income and substituting for it a tax on undistributed earnings, give up gradually the tax on corporate income and put in effect gradually the tax on undistributed earnings?"

HM, Jr. said, "I want to get back to the first thing. Does anybody here want to urge me not to do what I would like to do at one o'clock and that is, tell the President that I do not want to give up what revenue we have?" Dr. Viner asked, "Can't you reduce the legal risks?" Oliphant's reply was, "I do not say that there are serious legal risks." HM, Jr. remarked, "I simply sense that the risk is too great. Haas said that I cannot afford to take any risk." Oliphant's response was, "I think the risk involved is less than in the Gold Reserve Act and devaluation." "But the Gold Devaluation Act is the only one that stood up," HM, Jr. told Mr. Oliphant, "and against that there were 9 or 10 not in the Treasury that did not stand up and there were very able

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attorneys working on these various things, too."

Helvering expressed the opinion that "They are going to attack this bill. There is no question about that."

HM, Jr. then stated to the group, "For the moment, I want to stick to the fiscal responsibility."

Oliphant said, "Getting down underneath to the thing that will really affect the legislation -- if the rates are as high as they are in the House bill, then it will be as objectionable as present law, or more so. The inequities of the present law will be exaggerated. If all of those people in the lower income tax brackets who are now paying a rate of 15% (through the corporation income tax) on what the corporation earns for them are required to continue to pay that (instead of the lower rate they would pay if it were distributed to them) and then have an added tax to pay (in the form of a supertax on the corporation) their opposition will be soon developed. Moreover, such a proposal will alienate the support of all business corporations that have been distributing their earnings -- because it continues the burden on them. Let's take the A.T.&T. Under the House bill, they can continue to distribute their earnings and pay no tax. Their stockholders will have to pay under their respective brackets. Under the proposed revision, if the corporation continues to distribute all its earnings, it will have to pay the present tax of 15 per cent, and in addition its stockholders will have to pay a tax on the distributed earnings in their respective tax brackets."

HM, Jr.'s reaction was, "I think it is going to be very difficult to explain to the man on the street that A.T.&T. paid \$30,000,000 of taxes and that under this bill they will not pay any." Oliphant commented, "On the other side, it will be said that you are putting a tax on the legitimate corporation in order to set free a few large corporations who will not pay the tax under this bill."

Referring again to the plan worked on by Haas over the week-end, HM, Jr. said, "This tentative bill which Haas gave me will give me a fixed income and will force the corporations to pay out their withheld earnings and check evasions." Oliphant stated, "The tax bill as recommended by the Treasury has two great objectives: (1) elimination of tax avoidance,

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and, (2) equality on all taxpayers." HM, Jr. promptly remarked, "You forgot to give the most important of all, and that is revenue." Oliphant interjected, "That goes without saying." Continuing, HM, Jr. said, "I am sufficiently worried that if we went through next fall with this revenue cut out, I would not want to be responsible as to what would happen to business."

Dr. Viner made the following statement to the Secretary: "You do not have to overthrow the principle and you can accomplish your results by a little shifting of rates. I must say that I have not followed your bill closely, but I am assuming that the merits still stand. Then, I say, don't throw that over. I think the point that the Treasury must look sound this year is very important. I fully agree with that."

HM, Jr. told the group, "I would like you all to look at Haas' plan." Turning to Gaston he said, "There are two ways this thing can be done. The President can send for Pat Harrison and say, 'I am not going to hold out on this thing if you have some scheme. (Haas' plan is based on Harrison's.) Let's understand each other. I will give you a chance to do this thing, provided you give me your word of honor that you will go through with it and that I will not be left without a tax bill.' The other thing is for me to say before the Committee that after two or three months I want to say that it is too great a risk to give up what we have, but what we want on top of that is up to the Committee." Gaston's reply was, "I would not do it the latter way. I would prefer the first way. We still believe in the justice of this original proposal. I don't think we have sold our plan over to the Committee and if we did, the public would not be sold on the plan. I think the first way is the best way, if we finally decide that we want to make a compromise. I am impressed with Viner's plan."

HM, Jr. remarked, "I have not yet gotten an answer to my specific question." Gaston replied, "My answer to your question is that the President had better talk to Pat Harrison." And Viner added, "He had better speak to him with 'material.'" Upham had a suggestion, saying, "I suggest that Doughton ought to be in on that conference." And Viner had a further suggestion, viz: "I suggest that you ought to ask Professor

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Himmelblau of Northwestern University to come down as an advisor. I think he is a very able person with a fresh viewpoint." HM,Jr's reaction was, "Won't you telephone him and ask him to come down, at my request?"

Viner inquired, "Does the Harrison plan retain or eliminate the present capital stock tax and excess profit tax?" Helvering answered, "Pat Harrison's idea is to leave the present law just as it is, retaining these two taxes."

HM,Jr. then told the group, "Think this whole thing over and let's have another meeting at 3 o'clock."

At this point, a messenger came in and handed Mr. Oliphant a slip of paper and Oliphant reported that "The Senate Finance Committee has asked for experts from the Treasury and they want Turney and Haas." The group decided that inasmuch as Oliphant and Haas would not go up on the Hill until Tuesday morning that no one from the Treasury had better attend the Committee meeting.

The following is a conversation between Pat Harrison and Secretary Morgenthau making these arrangements:

HM,Jr; Hello.
 Operator: Senator Harrison.
 HM,Jr.: Hell - Pat
 H: Yes.
 HM,Jr; Your man O'Brien called up here and I thought I better talk to you myself. I've got everybody here in my own office that has had anything to do with the tax bill and we've got your question - we've got Senator Connally's, we've got Harry Byrd's and King's and we're going over all of these requests and we're just overwhelmed.
 H: Well
 HM,Jr: And Byrd mails a letter Saturday at 5 o'clock - I get it at 9:14 this morning and then I read it in the paper - the letter
 H: Well I thought everybody understood that we were to have this Executive Session - of course the Treasury experts ought to be in -
 HM,Jr: Well
 H: because now we're just questioning with reference to certain provisions of the bill.
 HM,Jr: Yes.
 H: You see?

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HM,Jr: Well I thought, maybe it's my fault and most likely is, that we'd have a day off to work amongst ourselves and then we'd be ready tomorrow.

H: Well I'll tell the Committee and you just keep the fellows up there then.

HM,Jr: Thank you very much.

H: What time is Oliphant coming before the Committee?

HM,Jr: He'll be ready at 10 o'clock tomorrow morning.

H: Well I'll tell the Committee then that you are all waiting on these requests.

HM,Jr.: Thank you very much - that's most helpful.

Upham telephoned Mrs. Klotz from the Hill at 11 o'clock and told her that in spite of the fact that none of the Treasury men were to appear in Executive Session today, Kent and Lusk were there. Upon inquiry, HM,Jr. learned that Mr. Oliphant had forgotten to tell Kent not to go. Upham also reported that the Committee asked Kent to get the names of the big stockholders who are evading taxes. It was Senator Black who specifically asked this question. The idea is to publish these names so as to force the House bill through.

After Mrs. Klotz gave HM,Jr. the message, he asked that Kent be present at the 2:30 meeting this afternoon.

Retention of all present corporation taxes with graduated tax on undistributed adjusted net income superimposed

1. Rate schedule.

a. Present graduated corporation income tax, corporate stock, and excess-profits taxes.

b. On the undistributed adjusted net income, bracket rates as follows:

No tax on the first 20 percent of adjusted net income retained;
 20 percent on the next 10 percent of adjusted net income retained;
 30 percent on the next 10 percent of adjusted net income retained;
 45 percent on the next 10 percent of adjusted net income retained;
 50 percent on all of the income retained in excess of 50 percent of the adjusted net income.

2. Corporations treated in a special manner, such as those in bankruptcy and those having contracts not to pay dividends, those with debts, etc., would be treated in the same manner as under the bill passed by the House. The amount of income to be subject to such special rates would be deducted from the adjusted net income together with the tax thereon, to determine the adjusted net income which would be subject to the regular rates on the amount undistributed.

3. Corporations with adjusted net incomes of less than \$20,000 would be subject to lower effective taxes on their undistributed adjusted net income in the following manner: after computing the tax in the usual way on the undistributed net income, such corporations would be subject to only such percentage of the computed tax as the percentage which their adjusted net income is of \$20,000.

4. Preliminary estimated yield (in millions of dollars):

| | | |
|--|--------------|-------|
| Statutory net income | \$7,200 | |
| Corporation income tax | <u>54</u> | \$964 |
| Statutory net income less tax | \$6,236 | |
| 90 percent of intercorporate dividends | <u>1,000</u> | |
| Adjusted net income | \$7,236 | |

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| | |
|--|--------------|
| Brought forward | \$964 |
| First 30 percent retained, \$1,447, no tax | 0 |
| Next 10 percent retained, \$724, at 30 percent | 145 |
| Next 10 percent retained, \$724, at 30 percent | 217 |
| Next 10 percent retained, \$724, at 45 percent | 326 |
| Capital stock and excess-profits taxes | <u>168</u> |
| Total | \$1,019 |
| Less present corporation taxes | <u>1,152</u> |
| | \$ 687 |
| Deduct loss on relief to small corporations | <u>47</u> |
| Net increase in revenue | \$ 640 |

Note: No loss in revenue because of the special provisions for certain debt corporations, etc., has been estimated, but the amount of such loss would be the same under this proposal as it is under the House bill.

Federal Tax Collections Estimated in the Budget
Message of January 3, 1936

(In millions of dollars)

| | <u>Fiscal year 1936</u> | <u>Fiscal year 1937</u> |
|--|---------------------------------|---------------------------------|
| Current corporation income taxes <u>1/</u> | 615 | 826.6 |
| Capital stock tax | 92 | 163 |
| Excess profits tax | <u>10</u> | <u>5</u> |
| Total | 717 | 994.6 |

Federal Tax Collections accruing in the
Calendar year 1936

(In millions of dollars)

| | |
|--|----------|
| Current Corporation income taxes <u>1/</u> | 964 |
| Capital stock tax | 163 |
| Excess profits tax | <u>5</u> |
| Total | 1,132 |

1/ Does not include back taxes.

5/12/36

Mr. Secretary:

This is a copy of the memorandum Mr. Oliphant
left on your desk Monday morning.

GENERAL STATEMENT ON THE OBJECTIONS TO THE
PROPOSED TAX ON WITHHELD CORPORATE EARNINGS PRESENTED
IN THE HEARINGS BEFORE THE SENATE FINANCE COMMITTEE ON THE
REVENUE ACT OF 1936

I should like first to take up briefly, one by one, a few of what seem to me to have been the most important of the objections which were urged against the proposed tax on withheld corporation earnings during the course of the public hearings on the Revenue Act, and our reasons for believing them ill-founded. Most of these objections have recurred in the testimony of at least a few of the witnesses before the Committee, and some of them have recurred in the testimony of practically every witness who has opposed this portion of the pending measure. I should be very glad to take up at the conclusion of this statement, or at any time as may please the Committee, such other objections as have been urged by witnesses appearing against the bill, or as may appear valid to members of the Committee.

In the first place, it has been urged by many witnesses that this bill does not represent an honest attempt to balance the budget and that any such attempt must begin first on the expenditure side. To answer this objection I need only briefly recapitulate the history of the bill. The President, in his budget message, stated that he did not contemplate requesting of Congress any additional taxes at this session but that any expenditures

additional to those provided for in the budget ought to be financed by new taxes. Since that time, the budget as set forth in the President's message has been seriously upset by the invalidation of the Agricultural Adjustment Act and the passage of the Soldier's Bonus legislation. This bill is intended only to restore the budget to the position which it occupied prior to these upsets. Such reasons as may exist for a thorough review of our expenses so that they may be equated to our probable revenues existed last December before either of these events occurred and have not been changed one way or another by the circumstances which have led up to the consideration of this bill. I ask, therefore, in all sincerity that the bill should be considered from the point of view only of the limited objective set forth in the President's special budget message, and that the matter of general budgetary balance should be treated on its own merits essentially as it would have been had this legislation not been necessary.

Secondly, I should like to say a few words about the criticisms which have been made of the Treasury estimates. In the first place, quite a bit has been made of the fact that only about half of the estimated revenue from incomes in the calendar year 1936 will be secured by the Government during the fiscal year 1937--i.e., that the estimated increase of revenues for the coming fiscal year will be only \$310,000,000 instead of \$820,000,000. This necessarily follows because incomes are customarily reported for calendar years, whereas the fiscal year of the United States runs from July 1 to June 30. The same difficulty would be present if we should raise

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the rate of the present corporation income tax, increase the rate of the normal individual income tax or the rates of the surtaxes in the lower brackets or resort to any other form of income taxation.

Next, still speaking of the revenue estimates, I should like to say again, although it is doubtless clear to all of you, that the point raised by Mr. May with respect to an alleged discrepancy between Secretary Morgenthau's and Commissioner Helvering's statements, pertained to the literary form of the statements only, and that the form in which the statements were expressed, is admittedly unfortunate, although in no way intentional. I wish to emphasize, however, that the figures behind the differing verbal forms of expression of the Secretary and the Commissioner were the same, as can easily be seen by a reference to the table submitted by Mr. McLeod on pages 35 and 36 of the revised House hearings and that the validity of our estimates is in no way involved in this alleged discrepancy.

Finally, still addressing myself to the estimates, I have no doubt but that you have all been impressed by Mr. May's criticism of Mr. McLeod's estimate of the proportion of corporation income which would be distributed in 1936, assuming a continuation of present law. Mr. May, you will recall, agrees substantially with Mr. McLeod's estimates of the total income but challenges his estimate of the amount which will be distributed. Mr. May bases

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his challenge primarily upon a consideration of the average amount of statutory net income distributed by corporations over a period of years. Many witnesses for the opposition have stated that averages are deceptive, and I believe that here we have a particular instance of that, as Mr. McLeod informs me that his estimates were based not upon a consideration of averages but on a consideration of the particular phase of the business cycle in which we now find ourselves. The proportion of corporation net earnings disbursed as dividends characteristically varies with the different phases of the business cycle—dividend disbursements substantially lagging behind net income, so that they fall far behind it during periods of revival and run ahead of it during periods of decline, the net resultant of these variations being the averages which Mr. May and other witnesses have quoted. In estimating the distribution for 1936, Mr. McLeod has taken past years, such as 1922, for example, which he considers most closely analogous with the year 1936, and it seems to me that his methodology ought to result in as accurate a forecast as may be made of a matter in which there are so many imponderables that the margin of error in any case must be large.

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So much for the revenue estimates. Let me now turn to the questions which have been raised with respect to the equities, economic effects, and administrative feasibility of the proposed tax. Mr. Alvord has objected that the Treasury has not presented facts and figures showing the amount of undistributed earnings which safely, soundly, and legally could have been distributed had those in control of the corporations been so disposed. Mr. Alvord, who is a real tax expert, knows that in asking for such figures he is asking for the impossible. The Treasury, of course, can not compile statistics on the magnitude of this source of tax evasion because there is no way to determine the magnitude of any of the individual units from which such statistics would have to be compiled. You gentlemen all know of the difficulties—almost impossibilities—of determining in any particular case the reasonable amount of surplus, accumulation over and above which constitutes tax evasion. It is these very difficulties which have prevented sections 102 and 351 of the present law, as such from raising any important amount of revenue. You can appreciate, then, what a labor of Sisyphus it would be to compile aggregates of such intractable units.

This leads me to a consideration of the number of witnesses who have suggested that objectives of this bill might be better attained by a stiffening of sections 102 and 351. I might first note in passing that all these suggestions have been couched in a general terminology and that no specific and concrete proposal for strengthening these sections has been presented to the Committee. Frankly, I doubt the sincerity of the people who advocate this, since you and I both know how great

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are the difficulties and how sparse have been the results of years of experimentation with these sections.

Even assuming, however, that these sections could have been provided with a real backbone we would not have attained the objectives of this measure and those who so state, I believe, misunderstand those objectives. As typical of such misunderstandings, let me take Mr. May's classification of all corporations into three groups—namely, (1) the large group of small corporations which he states do not in any event constitute a source of tax evasion, (2) the group of corporations, small in number but great in importance, which are publicly owned and whose dividend policies, according to Mr. May, are not at all governed by tax considerations, and finally (3) the small group of large closely-held corporations against which he states the bill is directed. Mr. May compares the bill with Herod's massacre in which there was a great slaughter of innocents in an attempt, ineffectual in that case, to reach a single individual. Likewise, in this case, Mr. May contends there will be a widespread slaughter of innocents—the small corporations and their stockholders and publicly-held corporations and their stock holders—in order to reach a few offenders. Mr. May's analogy is poorly put, for I assure you that there will be no slaughter of innocents if this bill is adopted. Contrary to the supposition of Mr. May and of so many of the witnesses who have appeared in opposition to it, the bill is not directed solely against conscious tax evasion. We are not interested in the motives which cause corporations to accumulate surpluses which in fact are never subjected to individual

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income taxation. These motives may have nothing to do with tax evasion. That such can be the case even in closely-held corporations is shown by the dividend policy of the Ford Motor Company prior to the adoption of the income tax. We are not interested in the motive of tax evasion but in the fact of lost revenue to the Federal Government which occurs when corporation earnings are neither distributed to stockholders and so subjected to the individual income tax, nor subjected to a compensatory tax in the hands of the corporation. Every corporation which would be subject to the proposed tax, those falling in Mr. May's first and second groups equally with those falling in his third, would be equitably subject to it on this principle, and the contrary impression so widely prevailing among the witnesses who have appeared before this Committee is based upon a complete misapprehension of purposes of the measure.

Next, I believe that we should take up the allegation urged by practically every witness who has appeared in opposition to it, that this tax would stunt the growth of small and struggling corporations and discriminate against them and in favor of large and well established corporations. I might first call your attention to the fact that while you have heard a great deal from people who have heard that large and powerful corporations desire this tax in order to stamp out their small competitors, or who have heard of people who have heard of this, that in no case has a representative of a large corporation appeared before you to advocate this tax. On the other hand, representatives of large and powerful corporations have appeared before you to oppose this tax out of solicitude for their smaller brothers.

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Let us look at the facts. We have urged that corporations, both large and small, can secure such capital as they need for the conduct of their operations by the sale of stock, either to stockholders or others, or by distribution of optional stock dividends as provided in section 115 of the bill. The stock to be sold to stockholders could, of course, be taken up out of the cash dividends disbursed to such stockholders in an amount equal to the earnings which would have been directly reinvested in the absence of the tax. Mr. Ballantine urges that this proposed methodology is impractical since up to 79% of the dividends so distributed will be taken by the Government in income taxes and so will not be available for resubscription. This is, in fact, the case to the extent that such dividends fall in income brackets of individual distributees in excess of \$5,000,000, but relatively few small and struggling corporations have principal stockholders whose incomes range to these figures. For most small corporations the amount which will be available for resubscription would be substantially larger under the proposed plan than under the present law. As a matter of fact, the proposed plan would in this respect give small corporations a break which they have never had before. Let me read you in this connection an excerpt from Mr. Haas' statement, which I believe covers the matter very thoroughly:

"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 the principal stockholders in large, prosperous, and well-established corporations. If, therefore, such principal stockholders subscribe back to the corporation for additional shares all or part of their dividend receipts, less the income tax thereupon, the

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proportion of the gross dividend receipts subscribed back by them will be much greater in the case of the average small corporation than in the case of the average large one. The great importance of the difference which exists because of the differing individual income-tax rates upon different income classes can best be seen when it is noted that while dividends which fall in the bracket between \$10,000 and \$12,000 of stockholders' individual incomes will be reduced by only 11 percent, or less than the present corporation taxes, by reason of the individual income tax, the dividends which fall in the income bracket between \$100,000 and \$150,000 will be reduced by a 62 percent individual income tax. In other words, a greater proportion of the earnings of small corporations will be available for reinvestment, when paid out to their stockholders, than of large corporation. I submit that this differential will give smaller corporations a chance to catch up upon their larger rivals which they never have had under any previous tax legislation."

So much for the proportion of earnings of small corporations which would be available for resubscription for new stock as compared with the proportion of earnings of large corporations which would be so available. How about the mechanical facility for getting the money back? As long as a corporation is really closely-held, as most small and struggling corporations are, this facility is well-nigh perfect. A year's earnings may be declared in dividends and resubscribed for stock and the whole operation completed between lunch and dinner. Compare this flexibility, peculiar to the small corporation, with the more cumbersome process by which a large corporation may secure the resubscription into its business of sums disbursed as dividends, and I believe that you will agree with me that the facility with which small corporations may recapture their earnings as additional invested capital under the proposed plan is in no way less than that with respect to large

corporations and that, indeed, the bill insofar as it alters the situation at all, makes lighter the handicap of the small corporation in the race for supremacy.

Here I should like to touch, in passing, upon the corollary objection that the bill would give an advantage to corporations whose stockholders are able to resubscribe their dividends for additional stock, as compared with corporations whose stockholders are not able to do this. Note that the alternative as presented by the present law is that such sums be directly invested by the corporation, and so not disbursed as dividends at all. What, may I ask, are the circumstances of stockholders who are perfectly able to forego dividends but if in receipt of them are unable to resubscribe them. I submit that this inability must be merely another term for unwillingness; and I submit also that if they are unwilling to resubscribe such dividends then their judgment ought to be and must be final and that it is not in our province to question it.

Next, in our presentation before your Committee and before the Ways and Means Committee of the House of Representatives, we have urged that the proposed Act would result in a greater measure of equality of opportunity between the three forms of business organization, i.e., individual proprietorships, partnerships, and corporations, than exists under the present law. Under the present law very small corporations are discriminated against since their net income is taxed at an average rate of approximately 15 to 16 percent, plus the individual income surtax on the amounts of income distributed

(provided the recipients thereof fall within the surtax brackets), and this rate of taxation may be greatly in excess of the rate to which the recipients would have been subject had they been operating as individual proprietors or members of partnerships. On the other hand, the present law discriminates very greatly in favor of large corporations since it permits the undistributed portion of their income to escape with a flat tax of about 16 $\frac{1}{2}$ percent, while the whole of their income, were it obtained from businesses conducted as individual proprietorships or partnerships, would be subjected to rates of taxation much higher.

It has been urged that this is unrealistic since in fact the types of business characteristically conducted by individual proprietorships, partnerships, and corporations are quite different and the three groups are essentially non-competitive. It has been further urged that insofar as they are competitive, the obvious remedy is for individual proprietorships and partnerships who do not like the discrimination to incorporate.

I do not believe that these objections will stand close scrutiny. The first seems to assume that we aim to achieve tax equality merely between competing concerns. I question if our perspective is so narrow. Retail merchants in New York and in California, barbers and makers of misses' dresses may hardly be said to compete but I have yet to hear it urged that they should, therefore, be subject to differential rates of taxation upon their

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net incomes. The fact is that our quest for equality in net income taxation is quite independent of competition, and your Committee would not for a moment listen to a proposal that net incomes derived from some occupations should be taxed at higher rates than those derived from others. Neither do I believe that the gentlemen who have urged this point to your Committee would favor such a differentiation, if the question were put to them de novo. But such is the inclination of all of us to justify inequities which we find already existing, that there seems to them to be no inconsistency in suggesting a lack of competition as a justification for taxing the earnings of stockbrokers, and if I may, lawyers, at a higher rate than those of manufacturers of children's rompers.

Let me turn next to the point that any one may escape this discrimination by incorporating. The most obvious reply to this is that it simply isn't so. It is a remedy which is not open, for example, to the legal profession, and I believe that the lawyer members of this Committee will agree with me that it will be a dark day when we commence the incorporation of our law firms in order to fit them into the framework of the present tax system. Neither is the device of a corporation open, for example, to members of the New York Stock Exchange.

Arguing more fundamentally, however, and independent of such special cases, are we justified in asking that people adapt the form of organization under which they do business to the single motive of minimizing taxes? The conduct of a private or investment

banking business by a partnership constitutes, for example, a grand gesture of good faith. It means that each partner in the enterprise is prepared to stake his whole personal fortune upon the safety of the funds entrusted to it and the integrity of its representations and warranties. It also means that he will be subject to income taxes ranging up to 79 percent on the income which he derives from the business as compared with corporation taxes aggregating only about 16 $\frac{1}{2}$ percent on the income of his competitors who are quite satisfied with the limited liability offered by a corporation. Here the discrimination in favor of the corporation and against the partnership constitutes nothing less than a surtax upon honor, and yet there are still partnerships of great size operating in these fields.

I do not believe that the answers which have been made by the witnesses of the opposition to our constructive case on this point are entitled to carry conviction. Let us look, therefore, to their own constructive case -- to the reasons which they advance why corporation earnings should be taxed at lower rates than if they accrued to individuals. These reasons in all of the many forms in which they have recurred throughout the testimony which you have heard during the past two weeks can be summed up into the general proposition that undistributed corporation earnings represent a form of savings, and that savings ought to be treated with a particular tenderness by the tax collector since they form the stuff from which our country has been built up and are the only means by which their progress may continue. There are economists who believe that under present circumstances we are suffering from over-saving rather than under-saving, but let us waive their arguments and go to the

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opposite extreme of granting for the moment the point made by these witnesses, i.e., that corporation savings should be accorded special treatment. Do not these gentlemen prove too much? The aspect of this income which is alleged to justify such special treatment is not that it accrues to corporations but that it is designated for saving. If then, we are to accord a preferential treatment to funds saved by corporations, we ought equally to accord such treatment to sums saved by individuals. Professor Irving Fisher, who is opposed to the pending plan, is perfectly consistent in this regard, and he urges that all savings whether by corporations or individuals should be exempted from taxation. Are you gentlemen willing to go this far, realizing that to do so would completely vitiate the productiveness of the higher brackets of the individual income tax, and force us to raise the great bulk of the revenue for the support of the Federal Government by excises on consumption? The question answers itself. Recurring then to the main point, if the savings of individuals are not to be accorded special tax treatment, neither should those of corporations, and I believe you will find upon reflection that most of the testimony which has been presented to you with respect to the necessity of according special treatment to those portions of corporation income used for expansion of plant capacity, increase in inventory, repayment of debt, etc., may be subsumed under this general principle.

An argument upon which opponents of the proposed tax policy, Mr. Noel Sargent for example, have laid considerable stress is that it would tend to intensify both booms and depressions. This undesirable consequence is supposed to result from the effects of increased dividend disbursements in good times and reduced disbursements in bad times upon the course of stock prices. As a matter of fact both common sense and generally accepted economic theory may be relied upon to establish just the contrary conclusion. The probability is much greater that booms and depressions would be reduced rather than increased in severity as a result of the proposed new tax.

During the '20's the practice of reinvesting a large proportion of corporate earnings led to three notable developments. First, there occurred an excessive expansion of plant and equipment in certain industries, notably in some branches of the building industry. Second, there took place an accumulation of idle surplus funds in the hands of corporations, which reduced the purchasing power necessary to maintain a smooth flow of industrial products. Finally, there was a great increase in corporate loans to the stock market, these loans serving to augment speculation. As a concrete illustration of the accumulation of idle corporate funds we may cite the increase of \$5.6 billions between 1926 and 1929 in the cash holdings of corporations reporting balance sheets to the Bureau of Internal Revenue. With respect to the financing of stock market speculation, brokers' "loans for the account of others", representing very largely the lending of unneeded corporate reserves, increased from \$600 million in

1926 to \$3,600 million in 1929.

A wider distribution of corporation earnings during this period, in place of so large a volume of reinvestment of earnings, would have served to reduce the force of each of these three causes of over-expansion and speculation. Moreover, to the extent to which additional dividends were spent for consumers' goods, wholesome industrial activity would have been more amply sustained. One other factor deserves mention in this connection. With the proposed tax in force, the financing of capital expansion would involve less dependence on reinvestment of earnings and increased dependence upon issues of stock. Clearly such additional stock issues would tend to reduce the rate of increase of stock prices and thereby the virulence of speculation.

Some of your witnesses lay considerable store by the charge that the proposed tax is a step in the direction of Government regulation and regimentation of business corporations. Mr. Noel Sargent in particular makes this assertion, on the ground that the tax "sets up a basic standard amount which should be retained as reserves and puts a tax penalty upon reserves beyond such arbitrary fixed standards." This argument will scarcely bear examination. The low corporate sur-tax rates on the first 30 to 40 per cent of reinvested income permit a moderate and reasonable use of this method of raising capital. If more is needed there are many other means of raising it, to some of

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which I have earlier referred in some detail. In view of these various and simple methods of increasing the capital of a corporation, it is to say the least an exaggeration to claim that the proposed tax involves "regimentation" and "planning". Were regimentation and planning contemplated, it would be necessary not only to abolish completely the process of direct reinvestment, but to impose rigid controls over the investment market. If the bill has the effect of bringing about a greater distribution of dividends it will have the result, not--as Mr. Sargent says--of "substituting Government discretion for that of management as to the amount of earnings which should be retained in the business," but of substituting the discretion of the actual owners of corporations, their stockholders, for that of their directors. So far as this might be accomplished the effect of the bill would be democratic rather than autocratic, in the direction of a more liberal rather than of a regimented economy.

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.

W.S.

OUTLINE OF GENERAL STATEMENT ON OBJECTIONS TO THE PROPOSED TAX
ON WITHHELD CORPORATE EARNINGS

1. Does not represent an honest attempt to balance budget. (page 1)
(Answer--Bill not intended to restore balance, but only to restore budget to position it occupied prior to invalidation of A.A.A. and passage of bonus legislation.)
2. Treasury estimates are not accurate and, even if they were, the estimated yield of \$310,000,000 is very small. (page 2)
(Answer--The \$310,000,000 is low because incomes are reported for calendar years, whereas the fiscal year runs from July 1 to June 30. Alleged discrepancy in figures quoted as to amounts of corporate earnings which will be withheld in no way affects validity of estimates. Explanation of estimates of future distributions.)
3. The Treasury has not produced figures which show the amount of undistributed earnings which could have been distributed in past years. (page 5)
(Answer--Such figures are unascertainable, but we do know that sections 102 and 351 have not, as such, been revenue producing measures.)
4. Why not strengthen sections 102 and 351? (page 5)
(Answer--This question involves the misconception as to objectives. Under the new bill we are not interested in motives of tax evasion but in the fact of lost revenues.)
5. The growth of small corporations will be stunted and monopoly will be fostered. (page 7)
(Answer--Resubscription devices analyzed. Mechanical facility in the case of small corporations pointed out.)
6. Corporations whose shareholders are not in a position to resubscribe will be prejudiced. (page 10)
(Answer--If they can forego dividends they can also resubscribe them if they are willing to. The bill does not attempt to influence their willingness.)
7. There is no real basis for the attempt to treat individuals, corporations, and partnerships equally. (page 11)
(Answer--Competitive differences should not be made a basis for tax discrimination. The suggestion that anyone may avoid inequality by incorporating not true.)
8. The new bill will be a penalty on savings. (page 13)
(Answer--It will treat all savings alike, whether the income is received by individuals or corporations.)
9. Booms and depressions will be accentuated. (page 15)
(Answer--The converse is more likely to be true judging by the events which led up to 1929.)

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10. This is a further step toward regimentation of business. (page 16)
(Answer--The fixing of rates to permit a reasonable use of income for reinvestment, at no higher rates than at present, together with the availability of resubscriptions, can not be called regimentation. On the other hand, it might lead to a more democratic corporate control.)

WHAT CAN BE SAID AGAINST
ADDING TAXES ON UNDISTRIBUTED EARNINGS
ON TOP OF CORPORATE INCOME TAX

The following is a brief summary of the arguments which may be urged against the adoption of any proposal to retain the present corporate tax and couple with it the tax on undistributed earnings as a surtax.

1. One of the primary purposes of the elimination of the present corporate income tax and the substitution therefor of the undistributed surplus tax was the removal of the present inequity of taxation of business profits as between incorporated businesses and those which are unincorporated. This plan would perpetuate and accentuate the inequity of the treatment of the small shareholder as against the large shareholder. Clearly the retention of the present corporate tax permits this inequity to inhere in our tax system.

It may be assumed that dividends would not be subject to normal tax. Even so, there would be serious injustice to the small stockholder of moderate means who would not be in the personal surtax class. His share of the corporate earnings would be subject to the flat corporate tax even though all of the corporate earnings were distributed.

2. Thus, a mixture such as proposed would not be justifiable upon the theory of equality or simplicity. It would be a hotch-potch, complicating our present system and justifiable only if it were the only way of getting new revenue. The Norwegian Government attempted this system and it has not worked out. Their "funds tax" was superimposed on corporate income taxes running over twenty per cent. This patchwork system attempts to embody inconsistent theories, i. e., the theory of paying whether or not you have and enjoy the income, and the theory of paying only if you have and enjoy the income.

3. Another important purpose of the House Bill is to eliminate a serious source of tax avoidance resulting from the accumulation of undistributed surpluses. Since retention of the corporate tax would make possible, and will probably result in, the adoption of lower surtax rates upon undistributed surpluses, to that extent there will still remain a wide area within which it will be possible to avoid individual surtaxes by the accumulation of surpluses in corporations.

If the proposed surtax is not high enough to prevent unnecessary corporate accumulations for the purpose of cutting down the surtaxes of large stockholders, the President's principle is abandoned. If the surtax on top of the flat corporate tax is made high enough to prevent large stockholders continuing to have arbitrary power to control corporate distributions to avoid their own taxes, then the bill would be as objectionable as the House Bill to those whom the latter affects and it would lose the support of those in corporations not using corporations to avoid surtaxes.

4. It would make impossible the application of the principle of ability to pay, since the size of a corporation income in no sense measures the ability of the individual and real owner of such income.

5. It increases the net tax load of corporations, (as opposed to that on stockholders avoiding their surtaxes) thereby checking recovery in two ways:

- (a) A flat tax can and will be passed on in higher prices and thus will reduce consumption.
- (b) To the extent it is not passed on, it will be a direct check on production.

6. It benefits only the large shareholder and the corporation officials through aiding the former to avoid the much higher surtaxes and the latter to control vast capital funds for personal aggrandizement and power. Only by

3.

taxing business profits at the equivalent of what they would be taxed in the hands of the individual owners shall we be able to exercise any effective control over credit and the use of such credit for speculative and manipulative purposes.

7. Let there be no mistake in respect to what is at stake. Issue is joined on the question of who is to control the vast capital and productive resources of the nation — it is more than a question of who must bear the additional tax load.

While I believe that the preceding point is the more important, related to it is the fact that those who seek to continue their control will also pay the greater part of the additional tax under the House Bill.

8. Politically any yielding would be a confession that we have lost the fight on point 7. I believe that the tax is a popular one with the great mass of citizens, and would be more popular if presented, as I believe it can be, in simple terms.

If we lose out, we shall invite trouble for the country, because too many of our industrial leaders have shown that they have learned nothing by the events of the last twenty years. The same old story will be repeated in greatly aggravated form.

5/11/36

May 11, 1936

2:30 p.m.

The same group met to discuss the tax bill with the addition of Kent.

HM, Jr. read the letter which was prepared in answer to Senator Byrd's letter.

"May 11, 1936

Honorable Harry Flood Byrd,
United States Senate.

My dear Senator:

This will acknowledge receipt of your letter, dated May 8th, which was postmarked as of 5:00 p.m. on May 9th and received in my office at 9:14 a.m. today.

In your letter you furnish a list of corporations with the amount of their net income and the amount of their dividends paid out in 1934, as reported in Moody's Manual, and you ask that I check this list and let you have a similar list for 1935 if such statistics are available. You request also the names of all corporations which, for the last year for which statistics are available, have a net income before Federal taxes of more than a million dollars and, based upon the actual distribution for the year, will receive a tax reduction of fifty per cent or more under the pending bill.

If the information you desire is that to be derived from income tax returns, I must respectfully call your attention to the provisions of the revenue law limiting the conditions under which the Treasury Department may furnish such information. Section 257-b of the Revenue Act of 1926, reads as follows:

'The Secretary and any officer or employee of the Treasury Department, upon request from the Committee on Ways and Means of the House of Representatives, the Committee on Finance of the Senate, or a select committee of the Senate or House specially authorized to investigate returns by a resolution of the Senate or House, or a joint committee so authorized by concurrent resolution, shall furnish such committee sitting in executive session with any data of any character contained in or shown by any return.'

I shall be quite willing, on request of the Finance Committee and under the authorization of this section, to furnish any and all information that the Committee may desire, which is available. Anticipating such a request, I have directed that data bearing on your inquiries be assembled without delay.

Sincerely yours,

(Signed) Henry Morgenthau, Jr.
Secretary of the Treasury."

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Kent then told the Secretary about the information that Senator Black had requested, that is, the names of the large stockholders who are evading taxes. HM, Jr. remarked, "While Senator Black was conducting the hearings on the war profits, he always asked for whatever information he wanted from the Treasury in writing. The request was always signed by the Chairman of the Committee. I suggest that you speak to Senator Black and ask that he confirm the request in writing."

The following letter was received from Senator Harrison confirming Senator Black's request:

Byrd?

"May 11, 1936

Honorable Henry Morgenthau, Jr.,
Secretary of the Treasury,
Washington, D.C.

Dear Mr. Secretary:

At the executive session meeting of the Finance Committee held today, requests for certain information to be obtained from income tax returns were made by members of the Committee. These requests met with the approval of the Committee, and, therefore, in behalf of the Committee I would ask for the following information:

First, I would request the information as set forth in a letter addressed to you by Senator Harry F. Byrd under date of May 8, 1936, a copy of which is attached hereto.

I would also ask that you furnish the Committee a list of our larger individual taxpayers by name who own stock in corporations, showing as far as possible the amount of dividends actually received and the amount of dividends in addition which they would have received if the principal corporations in which they owned stock had distributed all of their net income in dividends. In respect to these individuals, it is requested that the names of these principal corporations be shown and the amount of the net income and dividend payments made by such corporations. For the purpose of tax computation, the total income of these larger individual stockholders should also be shown. It is suggested that in connection with these large income taxpayers, you show in one column the amount of tax actually paid by the corporation on the profits which constituted their part of the corporate earnings as compared with the amount of tax that these individuals would have been required to pay on the same profits, if they had been received by them indirectly as dividends distributed.

Mr. Kent, Acting Chief Counsel of the Bureau of Internal

-3-

"Revenue was present during the discussion this morning, and can undoubtedly give you a more detailed analysis of the information requested. It appears that under Section 257 (b) of the Revenue Act of 1926, this information may properly be submitted to the Committee in executive session.

Sincerely yours,
(Signed) Pat Harrison."

Mr. Upham told the Secretary, "The Committee expects Mr. Oliphant to go up and defend the bill." Oliphant's response was, "I am not going up on the Hill as an economist but I am going up to answer such questions as relate to the legal side of the bill. I know what you are thinking, Mr. Upham, that the Committee will say that 'you did talk before the House; we want the same.' Well, just say that I did not understand what I was getting into. Upham's answer was, "There is a persistent belief on the Hill that it is Mr. Oliphant's bill and they expect him to go up and answer questions. They do not want the answers of an economist, but common sense answers that relate to policy." HM, Jr. said, "I cannot produce somebody out of the thin air to answer these questions." Haas then remarked, "I am not afraid to go, but I did not understand whether I should or should not go."

HM, Jr. told the group the following, "The President has asked Harrison and Doughton and myself to be at the White House at five o'clock. Has anybody got any ideas on Viner's 5-year plan? Let's call it a $4\frac{1}{2}$ or a $5\frac{1}{2}$ -year plan; let's not call it a 5-year plan! Have you made any progress?" Viner's answer was, "My $4\frac{1}{2}$ -year plan should be in the spirit of the present bill after a few years."

Speaking to Gaston, the Secretary asked, "At the press conference this afternoon, Herbert, do you think that I ought to say anything about Byrd's letter?" Gaston replied, "Yes, I do."

Turning to Mr. Kent, the Secretary asked him, "What feeling did you get this morning at the Executive Committee meeting?" Kent answered, "I would have picked not more than four or five of the Senators who are certain to vote for the House bill on a test vote. King tried to get a test vote and the other Senators objected and said the procedure would be improper. No such decision should be made until the proper representatives of the Treasury appear on the Hill and they all agreed." Asked by Mr. Morgenthau, "What kind

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of a bill do you think Harrison would like to have?", Mr. Kent replied, "He would like to retain a considerable part of the present corporate tax and superimpose a 15% tax on undistributed corporation earnings."

At this point, the Secretary gave the following information to the group: "When Jesse Jones was here, he asked that we do not make a written report on the Crowley-O'Connor fight. I half way agreed. The next day I talked to McReynolds and we agreed that it must be a written report. When I went to the White House today, McIntyre told me that O'Connor called him this morning and said that Jesse Jones does not want a written report, but that he, O'Connor, is going to demand of the President that the report be written. Then I walked into the President's room -- he sent for me before lunch -- to meet Carter Glass and Carter Glass was there protesting against the outrageous behavior of O'Connor and what a fine fellow Crowley is and that this thing has to stop.

"Yesterday, on the boat, Bert Wheeler said to the President, 'When are you going to get rid of that crook, Crowley?' and the President said, 'Better go slow, Bert, in calling people names.' McIntyre wants this report finished by Tuesday morning. In order to keep myself clear, I called up Jesse Jones at 1:15 today from the White House and told him that after further consideration we had decided that the report must be written.

"I also suggested to him that it might be a courteous thing for him to submit his testimony on the tax bill to the Treasury before he went up on the Hill, just the way Secretary Wallace did, to which he answered that he had a call in to discuss his testimony with me."

Oliphant pointed out that if HM, Jr. did make a written report, he ought to be careful to see that it does not fall into the hands of anybody but the direct channel to the President, because HM, Jr. might be held personally liable if misstatements of fact got into the hands of outside parties. HM, Jr. told McReynolds that this was a very good point raised by Oliphant and that he ought to make sure that the advice is followed. Oliphant also said that HM, Jr. was protected if Crowley is given a chance to say anything that he wants to say. McReynolds said that every precaution would be taken.

Resuming the tax discussion, HM, Jr. said to Oliphant,

-5-

"You will go up on the Hill tomorrow morning and Haas will stay here to defend the reputation of his figures. If the Committee wants Haas, he can go up in the afternoon." Oliphant said this in reply, "I do not want to go up on the Hill without Haas, because I will only answer the legal questions that are asked." HM, Jr. then made the following statement, "If Oliphant thinks it is unreasonable for him to go up without Haas, then I do not want him to go. I will ask Mr. May down Thursday instead of Tuesday, because you men will have to be up on the Hill. Let me go over to the five o'clock meeting at the White House and then I will come back and see when we can talk further about it after we know what will transpire between the President and Pat Harrison."

Sally M's Press Copy - ✓

Reply to Byrd

WCNS130

REFLECTING IRRITATION AT SENATOR BYRD FOR HAVING MADE PUBLIC A LETTER FROM BYRD TO HIM BEFORE HE HAD RECEIVED IT, SECRETARY MORGENTHAU TODAY VOICED HIS READINESS TO FURNISH THE SENATE FINANCE COMMITTEE WITH ANY INFORMATION THAT MAY BE REQUIRED.

MORGENTHAU EXPRESSED HIS READINESS TO TESTIFY BEFORE THE SENATE FINANCE COMMITTEE ON WEDNESDAY BUT SAID HE DOUBTED WHETHER HE COULD OBTAIN BY THAT DATE ALL THE INFORMATION FROM THE BUREAU OF INTERNAL REVENUE THAT THE COMMITTEE MIGHT REQUIRE.

MORGENTHAU SAID HE HAD DISPATCHED TO BYRD AN ANSWER TO THE LETTER WHICH BYRD SENT THE TREASURY REQUESTING A LIST OF CORPORATIONS WHICH BYRD DECLARED MIGHT ESCAPE ALL TAXES UNDER THE TAX BILL AS IT PASSED THE HOUSE.

5/12--R444P

May 11, 1936

After the Secretary returned from his 5 o'clock appointment with the President, at which Pat Harrison and Doughton were present, he called in Taylor, Haas, Upham, Gaston and McReynolds and gave them the following resume of the meeting.

He said, "Pat Harrison wants me, without fail, to come to the Hill Wednesday morning with a written statement in answer to Harry Byrd's letter, so he can give out my statement to the Press. Who is going to work on it and on the material for Senator Black?" Haas answered, "Helvering is getting it from the Statistical Section of the Bureau of Internal Revenue which is supposed to be under me." HM, Jr. then asked Haas, "Will you take the responsibility? I don't want to wait until midnight tomorrow night," to which Haas replied, "It is in my shop. I suppose I will have to take the responsibility." Gaston said, "I was over to see Helvering at noon and he had started Charley Russell, the Deputy in charge of income taxes, to work on it." HM, Jr. stated, "I just want to pin it on somebody," and McReynolds suggested, "Why don't you pin it on Charley Russell and relieve Haas just that much?" HM, Jr. agreed, saying, "That's what I thought. Do you want to follow it through, Mac, and see that by noon tomorrow we have something?" To George Haas the Secretary said, "I am doing this to relieve you, George," and Haas answered, "Fine! I appreciate it." The Secretary, speaking to McReynolds said, "Will you, before you go home, check on that" and McReynolds replied, "Everybody has gone home." The Secretary's instructions then were, "Let them come back tonight, and tell them that this has got to be in hand by lunch time tomorrow."

HM, Jr. then related the following to the group present: "As to what happened over at the White House, I had a swell glass of orange juice! As to what happened, I don't know. With one exception, the President spent most of his time discussing a memorandum handed to him today by Eccles. I think it is one of the most outrageous things. I can't make head or tail out of it and all the President would talk about was Eccles' memorandum on the tax bill. When he got through, I swear I don't know what it was all about. Doughton kept saying, 'You can't let us down. We have gone through this thing and we wanted to change it and Oliphant and Helvering wouldn't let us. We are sick and tired of giving in to the Senate.' The President said, 'We are not trying to let you down. I want a bill which will force distribution of surplus earnings and get me the revenue.' Pat was sort of

-2-

vague and they talked a lot about debt-ridden companies and debt-ridden railroads, so when he went out I said, "What are you going to do this thing?" and Pat answered, "Evidently the President is not ironclad on what he wants, but we do know that he wants a bill which will carry out his principles of forcing distribution and also getting the revenue and we are getting that, but he has told us his principles but has not definitely told us just how to do so." I don't think that is so bad.

I kept saying to Pat, "What are Oliphant and Haas going to have to do when they go up?" He said, "We want to have them answer all these various questions, so you will be up there Wednesday. I want you to have a written statement. I want to give it out to the press." I said, "All right, I will be there." I said, "Do I understand you are going to ask me two questions (1) to answer Senator Byrd and (2) to answer Senator Black?" He said, "That's all. But have that information." He said -- I think he is influenced by Senator Couzens -- that our estimates are not correct and that we are giving up an assured thing for a possibility.

I think it was the most confusing meeting. The President had seen Eccles just before lunch and he had that fresh in mind and kept pounding away on what Eccles wants, and I said, "After all, it's very nice that Eccles wants 40% or 60% or whatever he wants, but we need \$623,000,000 and you have to make your plan fit that. Did Eccles submit any estimates?" The President said, "Oh, no." So that's that!

They said, Let Oliphant and Haas come up and answer all the questions and put up the best fight they can for the bill. "I think that leaves you fellows clear," HM, Jr. said to Haas, to which Haas replied, "I think it leaves us right out on a limb because afterwards they change the bill, and then where are you?" HM, Jr.'s answer was, "They changed it last year, didn't they?" and Haas said, "Yes; they changed it.

Returning to discussion of the meeting at the White House, HM, Jr. said, "I practically did not open my mouth." Gaston commented that, "What the President said does give Harrison opportunity to draw a bill which will retain practically the flat tax and superimpose the undistributed." HM, Jr.'s response was, "I did not get that, but I did not want to be the person to say that." Upham remarked, "That's the Eccles plan. It is molded on the same line as the Harrison plan." HM, Jr.

-3-

at this point stated, "But I did not get that Pat Harrison said he was going to keep what we had and superimpose the new tax. I did not get it out of the meeting." Gaston gave his impression as follows: "From what he said, I would take it that way." Upham remarked, "The chief difficulty there is Doughton." HM, Jr. said, "Doughton stayed behind to fish for some political appointment. Where we have three vacancies on the Board of Tax Appeals, the tax bill is safe!"

Haas asked the Secretary, "Do you suppose Harrison would take Oliphant and me on the next day?" to which HM, Jr. replied, "No, I don't. I had to call him twice to get it postponed. He hopes to wind up on Wednesday."

The Secretary then related to the group his conversation with Pat Harrison about the Canadian liquor cases. He said, "Pat asked me about the Canadian liquor situation and I called up Harold Graves and Harold said they had gotten nowhere; that Technically the 30 days expires tomorrow night and any time beginning with this Wednesday was all right to have the bill introduced. Neither Harold nor Whitaker of the Justice Department felt that we could accept their offers, so I came back, told him this in front of the President and the President said, "Cordell Hull will be heart-broken, but, he said, 'Don't worry that they are going to cancel the Canadian treaty; they never will'." Furthermore, Cordell Hull won't admit that McKenzie-King got a great big contribution from the liquor people for his campaign fund."

4742

PA* HARRISON, MISS., CHAIRMAN
 WILLIAM H. KING, UTAH
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 DAVID I. WALSH, MASS.
 HERB W. BARKLEY, KY.
 IRA CONNALLY, TEX.
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 ARTHUR CAPPEN, KANS.

United States Senate

COMMITTEE ON FINANCE

May 11, 1936

Honorable Henry Morgenthau, Jr.,
 Secretary of the Treasury,
 Washington, D. C.

Dear Mr. Secretary:

At the executive session meeting of the Finance Committee held today, requests for certain information to be obtained from income tax returns were made by members of the Committee. These requests met with the approval of the Committee, and therefore, in behalf of the Committee I would ask for the following information:

First, I would request the information as set forth in a letter addressed to you by Senator Harry F. Byrd under date of May 8, 1936, a copy of which is attached hereto.

I would also ask that you furnish the Committee a list of our larger individual taxpayers by name who own stock in corporations, showing as far as possible the amount of dividends actually received and the amount of dividends in addition which they would have received if the principal corporations in which they owned stock had distributed all of their net income in dividends. In respect to these individuals, it is requested that the names of these principal corporations be shown and the amount of the net income and dividend payments made by such corporations. For the purpose of tax computation, the total income of these larger individual stockholders should also be shown. It is suggested that in connection with these large income taxpayers, you show in one column the amount of tax actually paid by the corporation on the profits which constituted their part of the corporate earnings as compared with the amount of tax that these individuals would have been required to pay on the same profits, if they had been received by them indirectly as dividends distributed.

Mr. Kent, Acting Chief Counsel of the Bureau of Internal Revenue was present during the discussion this morning, and can undoubtedly give you a more detailed analysis of the information requested. It appears that under Section 257 (b) of the Revenue Act of 1926, this information may properly be submitted to the Committee in executive session.

Sincerely yours,

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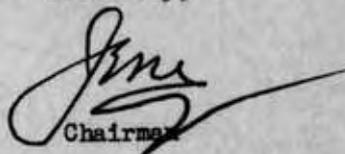
RECONSTRUCTION FINANCE CORPORATION**WASHINGTON**JESSE H. JONES
CHAIRMAN OF THE BOARD*Put in diary?*

May 11, 1936.

Dear Henry:

Enclosed is copy of a letter
I am sending to the Chairman of the Finance
Committee.

Sincerely,


Chairman

Honorable Henry Morgenthau, Jr.,
Secretary of the Treasury,
Treasury Department,
Washington, D. C.

RECONSTRUCTION FINANCE CORPORATION
WASHINGTON

May 11, 1936.

Dear Henry:

Enclosed is copy of a letter
I am sending to the Chairman of the Finance
Committee.

Sincerely,

(Signed) Jesse H. Jones

Chairman

Honorable Henry Morgenthau, Jr.,
Secretary of the Treasury,
Treasury Department,
Washington, D. C.

RECONSTRUCTION FINANCE CORPORATION
WASHINGTON

May 11, 1936

Dear Senator Harrison:

This Corporation has been requested to give some expression to your committee as to its attitude and opinion with respect to the fairness or advisability of exempting from the tax imposed by H. R. 12395 the adjusted income which bank holding company affiliates may be required to retain in order to comply with the provisions of guaranty agreements which they have entered into with this Corporation in connection with investments made by the Corporation in their subsidiaries.

If it is shown in any case that strict compliance with the provisions of any such agreement will impose an unfair burden upon the holding company, the Corporation will consent to reasonable modifications in the provisions of the agreement. Insofar as any of the rights and investments of this Corporation are concerned there would, therefore, seem to be no reason for suggesting any change in the bill, especially in view of the fact that section 15 of the bill already makes special provision for income which is required to be retained pursuant to agreements entered into prior to March 3, 1936.

I should like to add that the proposed manner of taxing banks seems entirely fair and highly desirable, in that while it requires banks to pay some additional taxes, it permits them to strengthen their capital structure, which is in the public interest.

I have not had time to study the bill carefully, but if substantial concessions could be made that would encourage modernization, new plant construction and new buildings to replace old ones, new equipment for railroads and industry of all kinds, including allowances for new debts created for these purposes, the employment situation, and business generally would in all probability be greatly helped, and society much better served.

You and your experts will know best the necessary formula. But, to illustrate, if a dollar so used, whether from earnings or borrowed money, could in substantial part be deducted in arriving at the adjusted net taxable income, the taxpayer would be encouraged to improve plant and equipment, thus stimulating the movement of capital goods and the employment of labor.

Sincerely yours,

(Signed) Jesse H. Jones
Chairman

Honorable Pat Harrison
Chairman, Finance Committee
United States Senate
Washington, D. C.

May 11, 1936

Attached is copy of a short memorandum regarding the tax bill which Eccles discussed and left with the President today and a copy of a longer one, covering a more detailed discussion of the question, which Eccles also left with the President.

May 11, 1936

Taxation of undistributed earnings of corporations, which is the underlying principle of the pending tax bill, is in my judgment highly desirable from the fiscal, economic, social, and monetary points of view. Existing great accumulations of cash in the hands of large corporations are, in fact, one of the important obstacles to recovery, since they interrupt the flow to consumers of money created by Government spending. A tax that would effectively force large corporations to pay out their current earnings would greatly contribute to the progress of recovery. It is because I am confident that the tax in the form in which it passed the House would not accomplish this purpose that I wish strongly to urge upon you certain modifications in the pending bill.

In its present form the tax bill will not achieve the objective specified in your message to Congress of securing "equality of tax burden on all corporate income, whether distributed or withheld from the beneficial owners". The tax has also become so complicated that instead of effecting "great simplification in tax procedure, in corporate accounting, and in the understanding of the whole subject by the citizens of the nation", it will be understood by few and will engulf many small corporations in unnecessary and difficult tax procedure. Grave questions have also been raised as to the revenue it will yield.

It seems to me that by the adoption of a few changes the objectives originally laid down for the tax will become much more certain of achievement.

- 2 -

1. My first proposal is that the present corporate income tax be retained. The argument for repealing this tax rests on the belief that it taxes the rich and the poor stockholders on the same basis regardless of ability to pay. This argument disregards the fact that the investment made by stockholders represents a price for the stock which takes into account the corporate income tax. Only such present holders as bought their stocks before the present tax was imposed have been unfavorably affected by the tax. Prices paid for stocks reflect net earnings to stockholders and are based on current and expected future earnings after deduction of taxes. To remove this tax now would increase per share earnings for all stockholders anywhere from 15 percent, in the case of operating companies with no preferred stock, to a hundred percent or more in the case of certain holding companies. Unless other taxes offset this advantage the elimination of the tax now would result in an unearned increase in the value of the stocks. With corporate profits increasing more rapidly than wages there is no reason for this unexpected addition to the wealth of stockholders. The purpose of the law should be to cause earnings to be paid out wherever possible and then be subject to individual income taxes which are graduated in accordance with ability to pay.

The retention of the corporate income tax would assure the continuance of revenue of over a billion dollars from a tax which has been in operation for a long time and is thoroughly accepted, established, and understood. Revenue from a new tax on undistributed earnings and from income taxes on increased dividend disbursements would be over and above

- 3 -

the existing tax and would be a net gain to the Treasury. Furthermore, the retention of the corporate income tax would make it possible to exempt small corporations and to apply the undistributed earnings tax exclusively to the small group of large corporations whose holdings of undistributed earnings is the difficulty that the law is designed to correct.

2. Adjusted net income up to \$15,000 should be exempt from the tax on undistributed earnings. In levying a tax on undistributed earnings it is essential to distinguish between large and small corporations. Smaller corporations have no ready access to the capital market, and also have difficulty in obtaining capital loans from banks. It is to meet their needs that the Government has provided special facilities through the Reconstruction Finance Corporation and the Federal Reserve banks for loans for working capital purposes to smaller businesses. It would not be consistent now to impose heavy taxes on such funds as these corporations may acquire in the course of their business. Small corporations, in general, depend on earnings for the development of their business. It would be inequitable and economically undesirable to apply an undistributed earnings tax to these corporations in the same manner as to large corporations. On the other hand, it would not be equitable to exempt small corporations entirely from taxation on their income, since this would permit their owners to escape tax-free. Retention of the existing corporate tax makes it possible to exempt small corporations without injustice or loss of revenues.

The House bill recognizes that small corporations have far more need of the privilege of retaining earnings than large corporations. That's why it provides lower rate schedules for small corporations. This, however, requires many small corporations to adjust themselves unnecessarily to new and difficult tax procedure, makes the tax more difficult to administer, and endangers the good will and support of hundreds of thousands of small corporations. If the corporation income tax is retained, the serious difficulties which have arisen in adapting the undistributed earnings tax to the financial problems of small corporations could be met by exempting earnings up to \$15,000 from the new tax, and thus altogether exempting from the tax the great numerical mass of corporations. The existing tax is adequate for these corporations, since it amounts to more than would the total personal income tax that would be paid by most of the stockholders if all the earnings were distributed. No revenue would be lost and the administration of the tax could be concentrated on the few thousand big corporations around which center the abuses of withheld earnings. Over 90 percent of all net income is earned by less than 10 percent of the corporations. Concentration of effort on these 10 percent would be a great help to the administration of the tax plan.

3. Much higher tax rates should apply to undistributed earnings.

For the large corporations toward which the tax is directed the tax rates should be high enough to force distribution of earnings. The proposed rates would not accomplish this. From 1923 to 1929 non-financial corporations reporting income paid dividends amounting to

- 5 -

57 percent of their income and retained \$25,000,000,000. Under the House schedules for large corporate incomes corporations could continue to disburse no larger percentage of their earnings as before in dividends and yet pay a tax of only $14\frac{1}{2}$ percent of adjusted net income. It would still be profitable for wealthy stockholders to have the corporations retain a large part of their earnings. Where this was done the purpose of the bill would be defeated.

The tax on undistributed earnings, after equitable deductions, should be high enough to force the distribution of earnings and to make it necessary for corporations to depend for expansion on borrowing or on the issuance of stock in the capital market. For big corporations this presents no difficulty. This proposal would be the most effective way of checking uneconomic bigness and of preventing important evasion of surtaxes.

In essence, my suggestions are that a heavy earnings tax be imposed on a few thousand big corporations if they did not distribute their earnings in dividends. This tax would be more effective than the tax in the House bill in closing up a loophole in the present law; it would greatly simplify the form and administration of the proposed tax; and could be easily explained and defended. It would also make the tax more popular and the number of its opponents much less numerous, because the large number of small companies would be relieved of the tax.

A detailed discussion of these and other changes is contained in the accompanying memorandum.

May 11, 1936.

SUGGESTED AMENDMENTS TO THE PROPOSED TAX ON UNDISTRIBUTED CORPORATE EARNINGS

In the President's message to the Congress containing the suggestion of a tax on undistributed earnings three of the objectives laid down were the raising of \$620,000,000 additional revenue, attaining equality of tax burden on all corporate income, whether distributed or withheld from the beneficial owners, and effecting simplification in tax procedure. In the form in which the proposals were passed by the House there is serious question whether any of these aims will be achieved. The following changes are suggested for the purpose of attaining these objectives:

1. The retention of the corporation income tax. In order to be certain that revenue will be raised, after making necessary exemptions, and that the form and administration of the proposed tax will be kept simple, it appears essential to retain the present corporation income tax.

The argument for its removal rests on two grounds, both of which may be questioned. In the first place, it is said that the present corporate income tax is inconsistent with the principle that taxation should be in accordance with ability to pay because it taxes rich and poor stockholders alike. This statement disregards the fact that the great majority of stockholders, all those who have acquired the stock since the enactment of the corporate income tax, have purchased the stock at a price based on the prospects of dividends after the tax has been paid. The invariable practice is to look upon the corporation income tax as an expense of production and to calculate earnings per share after taxes. If the corporation income tax were raised 100 percent this would be immediately discounted in the price of stocks,

with a consequent loss for present holders. In the future, however, purchasers would buy stocks on the basis of expected earnings per share after the additional tax and would suffer no loss. Similarly, a removal of the tax, in the absence of other equivalent taxes imposed at the same time, would constitute an unexpected gain for present holders of stocks. In cases where the company would distribute its earnings and not pay the new tax on retained income, per share earnings would be increased anywhere from 15 percent in the case of operating companies with no preferred stock outstanding to 100 percent or more in the case of holding companies that could benefit from the leverage factor.

In the second place, it is said that the corporation income tax imposes a burden on corporations as contrasted with partnerships and individuals. This can be true only of small corporations because large ones certainly pay less tax than would individual recipients of similar income; and owners of stock in small corporations, under existing law, benefit by the fact that a portion of the earnings is retained in the business and, therefore, escapes the personal income tax which it would have to pay if it were received by the individuals. Moreover, the corporate form of enterprise has certain concrete advantages over partnerships and individuals.

It would appear, therefore, that the retention of the corporation income tax involves no injustice to present owners of corporations. There is no reason why adoption of the principle of taxing undistributed earnings should result in elimination of the present corporate income tax. There is no necessary connection between the two matters. In fact it is easier to achieve the desired objectives by retention of the corporate income tax. This tax could

remain applicable to all corporations, including the small corporations which constitute the great majority and for which an undistributed earnings tax is unnecessary, while the undistributed earnings tax could be levied on the small number of large corporations whose practice of accumulating earnings gives rise to most of the problems the new legislation is designed to meet.

One advantage of retaining the corporation income tax is that such a course would eliminate the risk of losing revenue. If the normal tax is retained, then any additional amount produced by the tax on undistributed earnings would be a net gain for the Treasury. This would be true, whether the earnings were distributed and became subject to personal income taxes or retained and subject to the new tax. Another advantage would be that it would permit the necessary and desirable exemptions discussed below. Still another advantage would be that it would permit the tax on undistributed earnings to be greatly simplified.

The proposal to remove the exemption of dividends from the normal income tax should be retained. Corporation earnings have been increasing rapidly and the bulk of the dividends go to well-to-do people. A partial compensation for removing this exemption will be afforded by the removal of the excess profits and capital stock taxes.

2. The exemption of earnings of \$15,000 from the undistributed earnings tax. In 1933 only 14,815 corporate returns out of 446,842 returns for active corporations reported net earnings of \$15,000 and over, and this small group of returns accounted for over 90 percent of the net income for that year, the latest for which figures are available.

Even in 1929 when corporations reported for income tax purposes the largest net incomes of the post-war period, only about 50,000 of the 456,000 reporting corporations would have been required to file returns for the proposed tax on undistributed earnings if there were an exemption of \$15,000.

This small group of corporations, furthermore, would have accounted for 94 percent of the corporate net income reported for that year. With the proposed exemption, therefore, the tax on undistributed earnings would not apply to the great bulk of corporations which account for a small percentage of total corporate earnings.

It is generally agreed that small corporations must depend for their growth mainly on ploughing back earnings. They do not have the same access to the capital market as have corporations, and they have difficulty in obtaining loans for capital purposes from banks. It is for these reasons that the Government provided special facilities for capital loans for small concerns, through the R. F. C. and the Federal Reserve banks. In the House bill the needs of small corporations are recognized by the provisions that lower rates should apply to the undistributed earnings of corporations with earnings of less than \$10,000. The House was unable to exempt them altogether since, with the proposed repeal of the corporate income tax, this would have meant that the owners of small corporations could escape all income taxation by leaving earnings undistributed. Retention of the corporate income tax makes it possible without revenue loss to exempt small businesses altogether from the new tax. Even if all earnings were retained by these corporations they would still pay a tax of from $12\frac{1}{2}$ to 13 percent, which in most cases would be more than would be paid by the stockholders if the earnings were distributed.

This exemption would have a great public appeal. It would remove the opposition of nine-tenths of the corporations, and would make it necessary for the few thousand large corporations to show how taxing their undistributed

earnings would be undesirable, rather than to plead the cause of the small corporations, as they have shrewdly done.

The exemption of small corporations from the undistributed earnings tax, while leaving them subject to a well-understood corporate income tax, would be a major contribution toward the simplification of the Tax Bill. It would permit simplification of the undistributed earnings tax by substituting one rate schedule for two complicated schedules, each shown in the proposed law in two different ways, and a complicated method of using both sets of schedules in some instances. It would also permit the Treasury to concentrate its administrative staff on a relatively small number of returns, instead of trying to examine several hundred thousand. It is true that this small group of large corporations includes the most complicated corporate organizations of the country but this makes it the more important for the Treasury to have the use of its entire available staff for the effective administration of the new tax on these complex companies.

It has been suggested that an exemption of small corporations would permit wealthy individuals to continue to evade surtaxes by substituting a large number of small personal holding companies for existing large ones. This objection could be met by provisions denying this exemption to such personal holding companies, that is, to corporations 50 percent or more of whose stock is held by closely related individuals and 80 percent or more of whose gross income is derived from property, that is, dividends, interest, rents and royalties, and profits from the sale of assets.

3. Higher tax rates than those adopted by the House. When it comes to the tax on undistributed earnings the House bill proposes a relatively

low scale of rates. Under the terms of the bill many corporations, particularly the large ones, could retain as large a proportion of their earnings as they have in the past and still pay no larger tax. From 1923 to 1929 non-financial corporations reporting net income retained \$24,657,000,000 of earnings. Their dividends aggregated 57 percent of their earnings available for stockholders after taxes. Under the House schedules the tax on a corporation which pays out 57 percent of its adjusted net income in dividends will amount only to $14\frac{1}{2}$ percent of its adjusted net income. If corporations under the new tax will find it advantageous to retain as large a proportion of their earnings as they have in the past, the major objectives of the bill will be jeopardized. In the first place, wealthy individuals will still be enabled to avoid high surtax rates by leaving incomes undistributed with corporations. Secondly, the revenue yielded by the proposed changes will be lessened. Thirdly, the growth of uneconomic bigness will not be discouraged and consequently the trend toward lessened competition will not be impeded. Fourthly, the tax will fail to discourage the accumulation of cash on the part of large corporations, a practice which lessens the effectiveness of monetary control.

In order to attain the objectives of the tax it is imperative that higher rates be applied to undistributed earnings in excess of the specific exemption of \$15,000 and the earnings used to meet contractual obligations or to repay debt. It is suggested that the scale of graduation be along the following lines:

| <u>Percent of earnings undistributed</u> | <u>Rate of tax on undistributed earnings</u> |
|--|--|
| Not more than 50 percent | 40 percent |
| More than 50 percent | 60 percent |

Two other suggestions are made in connection with applying these rates:

(1) It is suggested that, following British practice in levying estate taxes, the highest rate applicable shall apply to all the undistributed earnings. For example, if 55 percent of earnings are undistributed, the 60 percent tax would apply to all undistributed earnings rather than a rate of 40 percent on the first 50 percent undistributed and a rate of 60 percent only on the balance.

(2) It is also recommended that, in determining the percentage of undistributed earnings, preferred stock dividend requirements be excluded from dividend disbursements, that is, that dividend requirements for preferred stock which is in effect a junior lien rather than an equity be included as a deduction in computing adjusted net income and be excluded from the dividend credit.

With few exceptions, preferred stockholders do not share in increased earnings and, therefore, do not have income on which they can evade taxation by leaving it with corporations. Under the House bill, common stockholders may point to a 60 percent distribution of their corporation earnings when actually a much smaller percent of their earnings (i.e., net available for common) is distributed. This is particularly important at the present time when many corporations have cumulated preferred stock dividends to pay before payments can be made on common stock.

The proposed law should be directed towards the prevention of tax evasion by common stockholders, and participating preferred stockholders. By determining the tax on the basis of earnings available for equity holders and undistributed to them, equality of treatment would be assured stockholders of corporations having preferred stock outstanding and those not having preferred stock outstanding.

This provision should apply only to non-participating preferred stock. Since it is proper to regard cumulative preferred stock as a junior debenture it would follow that arrears of dividends on preferred stock could be considered as a debt of the corporation, and be subject to the same treatment as other debts of the corporation. That is, earnings devoted to the payment of preferred stock dividend arrears should be subject to the 8 to 10 percent tax.

4. A low rate should apply to earnings withheld for debt retirement.

Although the House recognized the necessity of according special treatment to earnings devoted to debt retirement or withheld because of charter or statutory provisions, the omission of the corporate income tax necessitated the adoption of a $22\frac{1}{2}$ percent tax rate on earnings devoted to such purposes. Such a rate would in many cases be prohibitive. If the corporate income tax is retained it would be equitable to lower this rate to 8 percent. A rate of 8 percent would impose little burden on those corporations which for various reasons are forced to withhold earnings for the above purposes. It would be high enough, however, to encourage the liquidation of debt through new stock issues in cases where this is practicable. There is a great difference between a flat $22\frac{1}{2}$ percent rate on earnings used for debt retirement, and a corporate income tax rate of 15 percent plus an additional rate of 8 percent on earnings used for

this purpose. In the former case a corporation which is legally prohibited from paying out earnings or has to devote them to debt retirement has to pay $22\frac{1}{2}$ percent more than other corporations that are in a position to pay out all earnings. In the latter case a company which is obliged to repay debt would only have to pay 8 percent more than one that is not. The difference appears in a comparison with other corporations rather than in a comparison for a single corporation of payments before and after the proposed changes.

Furthermore, the House bill permits exemption with a flat rate only for certain types of debt, and limits it to the excess of such debt over accumulated earnings. Since, in the case of all debts outstanding on March 3, 1936, there were expectations at the time they were incurred that they could be retired out of earnings without penalty, it would appear equitable to make this provision apply to all debts outstanding on that date. There would appear to be no economic justification for limiting this provision to the excess of debts over accumulated earnings. It would be an almost impossible task to determine accumulated earnings, and in any case it is a bookkeeping item and has no reference to current or future ability to repay debt. Accumulated earnings do not represent cash funds; they may be represented by plant which is now worthless.

5. Suggested changes of a less important nature.

(1) It is recommended that the House provision be eliminated which permits a special low tax of 15 percent on the retention of current earnings which only serve to wipe out an accumulated deficit. This provision was apparently based on the theory that a corporation with an accumulated deficit is

in a straitened condition and should be accorded special treatment. But a bookkeeping figure of accumulated earnings or deficit has little relation to the financial condition of a corporation, nor to its current or future earning capacity. The retention of the provision will permit widespread evasion because of the extreme difficulty of determining the figure of accumulated earnings.

(2) It is recommended that the provision in the House bill relating to dividends paid to holding companies be eliminated. As has been pointed out in the Press, this provision may result in a multiplication of holding companies rather than a reduction, when the dividend receiver takes steps to insure that less than 50 percent of the dividends be paid to a single company. In cases where this cannot be done grave injustices will be suffered by existing holders of intermediate holding company stocks, which include not only holding companies but minority holders. The stocks acquired at prices based on existing tax laws should not be suddenly made to suffer severe depreciation by a change in the basis of taxation, particularly since the inclusion or exclusion of a company from the effects of the tax must depend on arbitrarily selected percentages.

It is said that the purpose of this provision is to prevent evasion whereby a chain of holding companies would pay neither taxes to the Government nor dividends to individuals. Such an evasion might have resulted from a definition of the dividend year (incorporated in an early draft of the bill) which would permit the lower holding company to pay its dividend in the period January 1 - March 15 to the next holding company, which in turn may pay its dividend in the corresponding period of the next year to the next holding company, and

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so on. But in the bill as passed by the House this definition of the dividend year was amended to coincide with the taxable year for earnings. This particular explanation of the holding company provision is, therefore, no longer relevant.

It is also suggested that for the purpose of the undistributed earnings tax, dividends received by a corporation shall be included in income, as proposed in the House bill, but that they be exempt from the corporate income tax to the extent provided by existing law.

Conclusion. If these suggested changes are adopted, the objections to the new tax proposals will be greatly lessened and their purposes will be more surely achieved. Additional revenue will be raised; there will be more assurance than under the present proposals that the wealthy will pay their share of income taxes; the purpose of forcing funds out of corporations, either in the form of debt repayment, or in dividends, or in taxes, will be better served; and, finally, these suggested changes would make for a tax far less complex than that passed by the House; a tax that could be more easily explained and defended.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

OFFICE OF THE CHAIRMAN



May 12, 1936.

MEMORANDUM:

TO - The Secretary of the Treasury
FROM - Chairman Eccles

In accordance with your request, I am enclosing two copies each of a short memorandum regarding the tax bill which I discussed and left with the President yesterday afternoon and a longer memorandum covering a more detailed discussion of the question, which I also left with the President.

If you desire additional copies, kindly let me know and I will be glad to furnish them.

A handwritten signature in cursive, appearing to be "W. C. Clegg", written over a horizontal line.

enclosures

May 11, 1936

Taxation of undistributed earnings of corporations, which is the underlying principle of the pending tax bill, is in my judgment highly desirable from the fiscal, economic, social, and monetary points of view. Existing great accumulations of cash in the hands of large corporations are, in fact, one of the important obstacles to recovery, since they interrupt the flow to consumers of money created by Government spending. A tax that would effectively force large corporations to pay out their current earnings would greatly contribute to the progress of recovery. It is because I am confident that the tax in the form in which it passed the House would not accomplish this purpose that I wish strongly to urge upon you certain modifications in the pending bill.

In its present form the tax bill will not achieve the objective specified in your message to Congress of securing "equality of tax burden on all corporate income, whether distributed or withheld from the beneficial owners". The tax has also become so complicated that instead of effecting "great simplification in tax procedure, in corporate accounting, and in the understanding of the whole subject by the citizens of the nation", it will be understood by few and will engulf many small corporations in unnecessary and difficult tax procedure. Grave questions have also been raised as to the revenue it will yield.

It seems to me that by the adoption of a few changes the objectives originally laid down for the tax will become much more certain of achievement.

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1. My first proposal is that the present corporate income tax be retained. The argument for repealing this tax rests on the belief that it taxes the rich and the poor stockholders on the same basis regardless of ability to pay. This argument disregards the fact that the investment made by stockholders represents a price for the stock which takes into account the corporate income tax. Only such present holders as bought their stocks before the present tax was imposed have been unfavorably affected by the tax. Prices paid for stocks reflect net earnings to stockholders and are based on current and expected future earnings after deduction of taxes. To remove this tax now would increase per share earnings for all stockholders anywhere from 15 percent, in the case of operating companies with no preferred stock, to a hundred percent or more in the case of certain holding companies. Unless other taxes offset this advantage the elimination of the tax now would result in an unearned increase in the value of the stocks. With corporate profits increasing more rapidly than wages there is no reason for this unexpected addition to the wealth of stockholders. The purpose of the law should be to cause earnings to be paid out wherever possible and then be subject to individual income taxes which are graduated in accordance with ability to pay.

The retention of the corporate income tax would assure the continuance of revenue of over a billion dollars from a tax which has been in operation for a long time and is thoroughly accepted, established, and understood. Revenue from a new tax on undistributed earnings and from income taxes on increased dividend disbursements would be over and above

the existing tax and would be a net gain to the Treasury. Furthermore, the retention of the corporate income tax would make it possible to exempt small corporations and to apply the undistributed earnings tax exclusively to the small group of large corporations whose holdings of undistributed earnings is the difficulty that the law is designed to correct.

2. Adjusted net income up to \$15,000 should be exempt from the tax on undistributed earnings. In levying a tax on undistributed earnings it is essential to distinguish between large and small corporations. Smaller corporations have no ready access to the capital market, and also have difficulty in obtaining capital loans from banks. It is to meet their needs that the Government has provided special facilities through the Reconstruction Finance Corporation and the Federal Reserve banks for loans for working capital purposes to smaller businesses. It would not be consistent now to impose heavy taxes on such funds as these corporations may acquire in the course of their business. Small corporations, in general, depend on earnings for the development of their business. It would be inequitable and economically undesirable to apply an undistributed earnings tax to these corporations in the same manner as to large corporations. On the other hand, it would not be equitable to exempt small corporations entirely from taxation on their income, since this would permit their owners to escape tax-free. Retention of the existing corporate tax makes it possible to exempt small corporations without injustice or loss of revenues.

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The House bill recognizes that small corporations have far more need of the privilege of retaining earnings than large corporations. That's why it provides lower rate schedules for small corporations. This, however, requires many small corporations to adjust themselves unnecessarily to new and difficult tax procedure, makes the tax more difficult to administer, and endangers the good will and support of hundreds of thousands of small corporations. If the corporation income tax is retained, the serious difficulties which have arisen in adapting the undistributed earnings tax to the financial problems of small corporations could be met by exempting earnings up to \$15,000 from the new tax, and thus altogether exempting from the tax the great numerical mass of corporations. The existing tax is adequate for these corporations, since it amounts to more than would the total personal income tax that would be paid by most of the stockholders if all the earnings were distributed. No revenue would be lost and the administration of the tax could be concentrated on the few thousand big corporations around which center the abuses of withheld earnings. Over 90 percent of all net income is earned by less than 10 percent of the corporations. Concentration of effort on these 10 percent would be a great help to the administration of the tax plan.

3. Much higher tax rates should apply to undistributed earnings.

For the large corporations toward which the tax is directed the tax rates should be high enough to force distribution of earnings. The proposed rates would not accomplish this. From 1923 to 1929 non-financial corporations reporting income paid dividends amounting to

57 percent of their income and retained \$25,000,000,000. Under the House schedules for large corporate incomes corporations could continue to disburse no larger percentage of their earnings as before in dividends and yet pay a tax of only 14½ percent of adjusted net income. It would still be profitable for wealthy stockholders to have the corporations retain a large part of their earnings. Where this was done the purpose of the bill would be defeated.

The tax on undistributed earnings, after equitable deductions, should be high enough to force the distribution of earnings and to make it necessary for corporations to depend for expansion on borrowing or on the issuance of stock in the capital market. For big corporations this presents no difficulty. This proposal would be the most effective way of checking uneconomic bigness and of preventing important evasion of surtaxes.

In essence, my suggestions are that a heavy earnings tax be imposed on a few thousand big corporations if they did not distribute their earnings in dividends. This tax would be more effective than the tax in the House bill in closing up a loophole in the present law; it would greatly simplify the form and administration of the proposed tax; and could be easily explained and defended. It would also make the tax more popular and the number of its opponents much less numerous, because the large number of small companies would be relieved of the tax.

A detailed discussion of these and other changes is contained in the accompanying memorandum.

May 11, 1936.

SUGGESTED AMENDMENTS TO THE PROPOSED TAX ON UNDISTRIBUTED CORPORATE EARNINGS

In the President's message to the Congress containing the suggestion of a tax on undistributed earnings three of the objectives laid down were the raising of \$620,000,000 additional revenue, attaining equality of tax burden on all corporate income, whether distributed or withheld from the beneficial owners, and effecting simplification in tax procedure. In the form in which the proposals were passed by the House there is serious question whether any of these aims will be achieved. The following changes are suggested for the purpose of attaining these objectives:

1. The retention of the corporation income tax. In order to be certain that revenue will be raised, after making necessary exemptions, and that the form and administration of the proposed tax will be kept simple, it appears essential to retain the present corporation income tax.

The argument for its removal rests on two grounds, both of which may be questioned. In the first place, it is said that the present corporate income tax is inconsistent with the principle that taxation should be in accordance with ability to pay because it taxes rich and poor stockholders alike. This statement disregards the fact that the great majority of stockholders, all those who have acquired the stock since the enactment of the corporate income tax, have purchased the stock at a price based on the prospects of dividends after the tax has been paid. The invariable practice is to look upon the corporation income tax as an expense of production and to calculate earnings per share after taxes. If the corporation income tax were raised 100 percent this would be immediately discounted in the price of stocks,

with a consequent loss for present holders. In the future, however, purchasers would buy stocks on the basis of expected earnings per share after the additional tax and would suffer no loss. Similarly, a removal of the tax, in the absence of other equivalent taxes imposed at the same time, would constitute an unexpected gain for present holders of stocks. In cases where the company would distribute its earnings and not pay the new tax on retained income, per share earnings would be increased anywhere from 15 percent in the case of operating companies with no preferred stock outstanding to 100 percent or more in the case of holding companies that could benefit from the leverage factor.

In the second place, it is said that the corporation income tax imposes a burden on corporations as contrasted with partnerships and individuals. This can be true only of small corporations because large ones certainly pay less tax than would individual recipients of similar income; and owners of stock in small corporations, under existing law, benefit by the fact that a portion of the earnings is retained in the business and, therefore, escapes the personal income tax which it would have to pay if it were received by the individuals. Moreover, the corporate form of enterprise has certain concrete advantages over partnerships and individuals.

It would appear, therefore, that the retention of the corporation income tax involves no injustice to present owners of corporations. There is no reason why adoption of the principle of taxing undistributed earnings should result in elimination of the present corporate income tax. There is no necessary connection between the two matters. In fact it is easier to achieve the desired objectives by retention of the corporate income tax. This tax could

remain applicable to all corporations, including the small corporations which constitute the great majority and for which an undistributed earnings tax is unnecessary, while the undistributed earnings tax could be levied on the small number of large corporations whose practice of accumulating earnings gives rise to most of the problems the new legislation is designed to meet.

One advantage of retaining the corporation income tax is that such a course would eliminate the risk of losing revenue. If the normal tax is retained, then any additional amount produced by the tax on undistributed earnings would be a net gain for the Treasury. This would be true, whether the earnings were distributed and became subject to personal income taxes or retained and subject to the new tax. Another advantage would be that it would permit the necessary and desirable exemptions discussed below. Still another advantage would be that it would permit the tax on undistributed earnings to be greatly simplified.

The proposal to remove the exemption of dividends from the normal income tax should be retained. Corporation earnings have been increasing rapidly and the bulk of the dividends go to well-to-do people. A partial compensation for removing this exemption will be afforded by the removal of the excess profits and capital stock taxes.

2. The exemption of earnings of \$15,000 from the undistributed earnings tax. In 1933 only 14,815 corporate returns out of 446,842 returns for active corporations reported net earnings of \$15,000 and over, and this small group of returns accounted for over 90 percent of the net income for that year, the latest for which figures are available.

Even in 1929 when corporations reported for income tax purposes the largest net incomes of the post-war period, only about 50,000 of the 456,000 reporting corporations would have been required to file returns for the proposed tax on undistributed earnings if there were an exemption of \$15,000.

This small group of corporations, furthermore, would have accounted for 94 percent of the corporate net income reported for that year. With the proposed exemption, therefore, the tax on undistributed earnings would not apply to the great bulk of corporations which account for a small percentage of total corporate earnings.

It is generally agreed that small corporations must depend for their growth mainly on ploughing back earnings. They do not have the same access to the capital market as have corporations, and they have difficulty in obtaining loans for capital purposes from banks. It is for these reasons that the Government provided special facilities for capital loans for small concerns, through the R. F. C. and the Federal Reserve banks. In the House bill the needs of small corporations are recognized by the provisions that lower rates should apply to the undistributed earnings of corporations with earnings of less than \$10,000. The House was unable to exempt them altogether since, with the proposed repeal of the corporate income tax, this would have meant that the owners of small corporations could escape all income taxation by leaving earnings undistributed. Retention of the corporate income tax makes it possible without revenue loss to exempt small businesses altogether from the new tax. Even if all earnings were retained by these corporations they would still pay a tax of from 12½ to 15 percent, which in most cases would be more than would be paid by the stockholders if the earnings were distributed.

This exemption would have a great public appeal. It would remove the opposition of nine-tenths of the corporations, and would make it necessary for the few thousand large corporations to show how taxing their undistributed

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earnings would be undesirable, rather than to plead the cause of the small corporations, as they have shrewdly done.

The exemption of small corporations from the undistributed earnings tax, while leaving them subject to a well-understood corporate income tax, would be a major contribution toward the simplification of the Tax Bill. It would permit simplification of the undistributed earnings tax by substituting one rate schedule for two complicated schedules, each shown in the proposed law in two different ways, and a complicated method of using both sets of schedules in some instances. It would also permit the Treasury to concentrate its administrative staff on a relatively small number of returns, instead of trying to examine several hundred thousand. It is true that this small group of large corporations includes the most complicated corporate organizations of the country but this makes it the more important for the Treasury to have the use of its entire available staff for the effective administration of the new tax on these complex companies.

It has been suggested that an exemption of small corporations would permit wealthy individuals to continue to evade surtaxes by substituting a large number of small personal holding companies for existing large ones. This objection could be met by provisions denying this exemption to such personal holding companies, that is, to corporations 50 percent or more of whose stock is held by closely related individuals and 80 percent or more of whose gross income is derived from property, that is, dividends, interest, rents and royalties, and profits from the sale of assets.

5. Higher tax rates than those adopted by the House. When it comes to the tax on undistributed earnings the House bill proposes a relatively

low scale of rates. Under the terms of the bill many corporations, particularly the large ones, could retain as large a proportion of their earnings as they have in the past and still pay no larger tax. From 1923 to 1929 non-financial corporations reporting net income retained \$24,657,000,000 of earnings. Their dividends aggregated 57 percent of their earnings available for stockholders after taxes. Under the House schedules the tax on a corporation which pays out 57 percent of its adjusted net income in dividends will amount only to 14½ percent of its adjusted net income. If corporations under the new tax will find it advantageous to retain as large a proportion of their earnings as they have in the past, the major objectives of the bill will be jeopardized. In the first place, wealthy individuals will still be enabled to avoid high surtax rates by leaving incomes undistributed with corporations. Secondly, the revenue yielded by the proposed changes will be lessened. Thirdly, the growth of uneconomic bigness will not be discouraged and consequently the trend toward lessened competition will not be impeded. Fourthly, the tax will fail to discourage the accumulation of cash on the part of large corporations, a practice which lessens the effectiveness of monetary control.

In order to attain the objectives of the tax it is imperative that higher rates be applied to undistributed earnings in excess of the specific exemption of \$15,000 and the earnings used to meet contractual obligations or to repay debt. It is suggested that the scale of graduation be along the following lines:

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| <u>Percent of earnings undistributed</u> | <u>Rate of tax on undistributed earnings</u> |
|--|--|
| Not more than 50 percent | 40 percent |
| More than 50 percent | 60 percent |

Two other suggestions are made in connection with applying these rates:

(1) It is suggested that, following British practice in levying estate taxes, the highest rate applicable shall apply to all the undistributed earnings. For example, if 55 percent of earnings are undistributed, the 60 percent tax would apply to all undistributed earnings rather than a rate of 40 percent on the first 50 percent undistributed and a rate of 60 percent only on the balance.

(2) It is also recommended that, in determining the percentage of undistributed earnings, preferred stock dividend requirements be excluded from dividend disbursements, that is, that dividend requirements for preferred stock which is in effect a junior lien rather than an equity be included as a deduction in computing adjusted net income and be excluded from the dividend credit.

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The proposed law should be directed towards the prevention of tax evasion by common stockholders, and participating preferred stockholders. By determining the tax on the basis of earnings available for equity holders and undistributed to them, equality of treatment would be assured stockholders of corporations having preferred stock outstanding and those not having preferred stock outstanding.

This provision should apply only to non-participating preferred stock. Since it is proper to regard cumulative preferred stock as a junior debenture it would follow that arrears of dividends on preferred stock could be considered as a debt of the corporation, and be subject to the same treatment as other debts of the corporation. That is, earnings devoted to the payment of preferred stock dividend arrears should be subject to the 8 to 10 percent tax.

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this purpose. In the former case a corporation which is legally prohibited from paying out earnings or has to devote them to debt retirement has to pay $22\frac{1}{2}$ percent more than other corporations that are in a position to pay out all earnings. In the latter case a company which is obliged to repay debt would only have to pay 8 percent more than one that is not. The difference appears in a comparison with other corporations rather than in a comparison for a single corporation of payments before and after the proposed changes.

Furthermore, the House bill permits exemption with a flat rate only for certain types of debt, and limits it to the excess of such debt over accumulated earnings. Since, in the case of all debts outstanding on March 3, 1936, there were expectations at the time they were incurred that they could be retired out of earnings without penalty, it would appear equitable to make this provision apply to all debts outstanding on that date. There would appear to be no economic justification for limiting this provision to the excess of debts over accumulated earnings. It would be an almost impossible task to determine accumulated earnings, and in any case it is a bookkeeping item and has no reference to current or future ability to repay debt. Accumulated earnings do not represent cash funds; they may be represented by plant which is now worthless.

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in a straitened condition and should be accorded special treatment. But a bookkeeping figure of accumulated earnings or deficit has little relation to the financial condition of a corporation, nor to its current or future earning capacity. The retention of the provision will permit widespread evasion because of the extreme difficulty of determining the figure of accumulated earnings.

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It is said that the purpose of this provision is to prevent evasion whereby a chain of holding companies would pay neither taxes to the Government nor dividends to individuals. Such an evasion might have resulted from a definition of the dividend year (incorporated in an early draft of the bill) which would permit the lower holding company to pay its dividend in the period January 1 - March 15 to the next holding company, which in turn may pay its dividend in the corresponding period of the next year to the next holding company, and

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so on. But in the bill as passed by the House this definition of the dividend year was amended to coincide with the taxable year for earnings. This particular explanation of the holding company provision is, therefore, no longer relevant.

It is also suggested that for the purpose of the undistributed earnings tax, dividends received by a corporation shall be included in income, as proposed in the House bill, but that they be exempt from the corporate income tax to the extent provided by existing law.

Conclusion. If these suggested changes are adopted, the objections to the new tax proposals will be greatly lessened and their purposes will be more surely achieved. Additional revenue will be raised; there will be more assurance than under the present proposals that the wealthy will pay their share of income taxes; the purpose of forcing funds out of corporations, either in the form of debt repayment, or in dividends, or in taxes, will be better served; and, finally, these suggested changes would make for a tax far less complex than that passed by the House; a tax that could be more easily explained and defended.

COPY

May 12, 1936

My dear Senator:

I am in receipt of your letter of May 11.

The Treasury will be glad to comply with your request and will furnish you with this information, via Chairman Harrison, just as soon as it is humanly possible for our staff to do so.

Sincerely yours,

Hon. Tom Connally,
United States Senate.

TOM DONOHUE, TENN., CHAIRMAN
 ARNOLD, ARIZ.
 DANIEL, FLA.
 E. TYDINGS, MD.
 WALSH, MASS.
 T. MALONEY, CONN.
 THURMAN, MO.
 CHAYES, N. MEX.

HENRIK CHRISTENSEN, MINN.
 ROBERT M. JACKSON, CLERM.

United States Senate

COMMITTEE ON
 PUBLIC BUILDINGS AND GROUNDS

May 11, 1936

Hon. Henry Morgenthau,
 Secretary of the Treasury,
 Washington, D.C.

My dear Mr. Secretary:

In connection with the consideration by the Senate Finance Committee of the pending tax bill I desire to request that the Treasury Department supply me with estimates at the earliest possible moment of a yield of revenue based on the following provisions:

- (1) Impose the 4% normal tax on dividends received by individual income tax payers.
- (2) Impose a 15% flat tax on the net adjusted income of all corporations
- (3) Impose a graduated supertax on that portion of the net adjusted income of corporations which is not distributed to their stockholders as follows:
 - (a) On the first 20% of such net adjusted income (after the payment on the total net adjusted income of the 15% flat corporation tax), no supertax.
 - (b) On the second 20% of such net adjusted income retained, 10%.
 - (c) On the third 20% of such net adjusted income retained, 13%.
 - (d) On the fourth 20% of such net adjusted income retained, 16%.
 - (3) On the fifth 20% of such net adjusted income retained, 20%.

In view of the meeting of the Finance Committee on Tuesday, I shall be pleased to have estimates at that time.

Thanking you for your attention, I am
 Sincerely,

Sam Ervin

May 12, 1936

98

My dear Senator:

I am in receipt of your letter of
May 11.

The Treasury will be glad to comply
with your request and will furnish you
with the information you request, via
Chairman Harrison, just as soon as it
is humanly possible for our staff to do
so.

Sincerely yours,

Secretary of the Treasury

Hon. Tom Connally,
United States Senate.

By Hand
9:12 am
5/12/36.
mnc

TOM CONNALLY, TEX., CHAIRMAN
 HENRY F. ASHurst, ARIZ.
 HENRY W. HEYER, N. H.
 L. J. DICKINSON, IOWA
 JOHN TRAMMELL, FLA.
 WARREN H. AUSTIN, VA.
 CLAYTON E. TYDINGS, MD.
 W. WARREN BARBOUR, N. J.
 ANDREW L. WALSH, MASS.
 JAMES T. MALONEY, CONN.
 HARRY S. TRUMAN, MO.
 JAMES CHAVEZ, N. MEX.

United States Senate

COMMITTEE ON
 PUBLIC BUILDINGS AND GROUNDS

May 11, 1936

LEONARD SHEPHERD, MINN.

ROBERT M. JACKSON, CLERK

Hon. Henry Morgenthau,
 Secretary of the Treasury,
 Washington, D.C.

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Thanking you for your attention, I am

Sincerely,

Sam Cunniff

United States Senate

COMMITTEE ON
PUBLIC BUILDINGS AND GROUNDS

FREE

BY RIDING PAGE

PERSONAL

HON HENRY MORGENTHAU
SECRETARY OF THE TREASURY
WASHINGTON D C

John C. ...
U.S.S.

May 12, 1936

The tax group met with the Secretary today at 9:30. Mr. Helvering and Mr. Kent were not present.

HM, Jr. called Secretary Wallace and said to him over the 'phone, "I have had a chance to talk to our people and they think you are going on first to testify this morning and immediately following you will come Oliphant. He will ask Harrison to ask him the question, 'Does the Treasury concur in the position taken by the Secretary of Agriculture as to the method of handling Section 21-D' and Oliphant will say, No. This is the way we feel about it." Wallace agreed.

HM, Jr. then told the group that "Arthur Anderson's partner, Mr. Burns, and an assistant, have come down and since Haas is going up on the Hill, I would like Bell to be host to these men until Haas gets back."

Speaking to Oliphant, HM, Jr. said, "I would like you to assign a lawyer who can work with McReynolds on the material which they are getting together for Senator Byrd." Oliphant said he would assign Clarence Oppen.

At this point, Haas and Oliphant again began the argument as to who would discuss the economic phase of the tax bill before the Senate Finance Committee this morning. HM, Jr. said, "I really think both of you had better drop this thing. I have been awfully temperate. If we continue very much longer, I am going to blow up. The performance last night with Haas was awful. I have not said anything about it. I think I have reached my limit." Haas, interrupting, said, "To date I think I have held up my end of this thing." Resuming his remarks, HM, Jr. said, "This argument which Haas is bringing up again -- he and I had this thing up last night. Let's have this thing out once and for all. George flatly refused to go up on the Hill." Haas denied this, saying, "I did not flatly refuse." HM, Jr. said, "Yes, you did! You threatened to resign and I have just reached my limit." Haas said, "I said I was physically incapacitated." And HM, Jr. remarked, "I can't go up on the Hill and testify for you." Oliphant said, "Do you want me to take the whole thing, Henry?" HM, Jr. replied, "No. I will not ask anybody to do differently than what has been done. You said you would go up and handle the legal end. You said it is not fair to you to go up without George and I said, O. K.; George will go."

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Haas said, "I will take the economic side. That is different from asking me to give the statement which Oliphant has prepared. (This is the statement which was prepared by 13 of Oliphant's men.) HM, Jr. wanted to know, "Who was this statement prepared for?" and Oliphant replied, "My men were assuming that I was going to give it." Haas stated, "I will not give it." HM, Jr. told the men, "It is much better to blow up in this office than have the blow-up in the Committee on the Hill."

At this point, Oliphant remarked, "I think George and I are clicking on this thing." But HM, Jr. disagreed, saying, "No, I don't think you are. What will happen when they begin to ask questions? Who will answer them? Is this bill a stepchild suddenly?" Oliphant said, "I don't think the Committee will want a prepared statement. I think they will simply ask questions." HM, Jr. made this comment to Oliphant, "When you were before the House Committee, you assumed the responsibility of answering all the questions," to which Oliphant replied, "I did not know what I was going up there for, but when I got there perhaps I foolishly answered a lot of questions." At this point, McReynolds remarked to Oliphant, "No, I don't think you did answer them foolishly at all. I think you did very well. I think the Committee will look to Oliphant and then he can turn to the other men to answer questions. I am not worried about this at all." Gaston then made the following observation: "The trouble is that we have had no Under-secretary to carry this thing through. We have placed Guy Helvering in that position and, frankly, he is not up to that job. It seems to me that Oliphant is the only man who is prepared to do it."

"The fact is as you stated," HM, Jr. told the group, "and Oliphant knows that up to now he has carried the ball on this thing and has been captain of this tax bill. Herman, you devoted yourself almost exclusively to this for two or three months. The fact that we have no Under-secretary has not changed this thing one iota. If Coolidge were here, it would not have been one bit different. You would have carried the thing just the same. I think it is up to you to go through with it." To which Oliphant replied, "I will have the aid and comfort of my friend, George Haas." And HM, Jr. said, "I know you will. I have looked at the statement that was prepared by your 13 men. I think it is swell. I think it is good we had this talk." Oliphant replied, "I

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agree. We are getting acquainted." Continuing, HM, Jr. said, "Last night, Haas refused to go on the Hill. He flatly refused. He said he would resign. I gave my word to Oliphant that he would go and I told George that he had to go, whether he liked it or not. He then said that he could not prepare the report for Anderson because he had to devote the evening to preparing his testimony. I then told him to put Anderson's report aside."

At this point, Haas almost broke down. He said he would not double-cross Mr. Morgenthau or Mr. Oliphant or anybody, but he did not see why he was asked to go up and carry the ball when all he was prepared to do was to defend the figures that he prepared for the tax bill.

provided for in the budget ought to be financed by new taxes. Since that time, the budget as set forth in the President's message has been seriously upset by the invalidation of the Agricultural Adjustment Act and the passage of the Soldier's Bonus legislation. This bill is intended only to restore the budget to the position which it occupied prior to these upsets. Such reasons as may exist for a thorough review of our expenses so that they may be equated to our probable revenues existed last December before either of these events occurred and have not been changed one way or another by the circumstances which have led up to the consideration of this bill. I ask, therefore, that in all fairness the bill be considered from the point of view only of the limited objective set forth in the President's special budget message, and that the matter of general budgetary balance should be treated on its own merits essentially as it would have been had this legislation not been necessary.

II.

Are the Treasury Estimates Dependable?

Secondly, a word about the criticisms which have been made of the Treasury estimates. In the first place, quite a bit has been made of the fact that only about half of the estimated revenue from incomes in the calendar year 1936 will be secured by the Government during the fiscal year 1937--i.e., that the estimated increase of revenues for the coming fiscal year will be only \$310,000,000 instead of \$623,000,000. There is nothing novel about that. This necessarily follows an enactment of any income tax because incomes are customarily reported for calendar years, whereas the fiscal year of the United States runs from July 1 to June 30. The same difficulty would be present if we should raise

the rate of the present corporation income tax, or increase the rate of the normal individual income tax or raise the rates of the surtaxes in the lower brackets or resort to any other new form of income taxation.

Finally, still addressing myself to the estimates, I have no doubt but that you have all been impressed by Mr. May's criticism of the Treasury's estimate of the proportion of corporation income which would be distributed in 1936, assuming a continuation of present law. Mr. May, you will recall, agrees substantially with the Treasury's estimates of the total income, but challenges the Treasury's estimate of the amount which will be distributed. Mr. May bases his challenge primarily upon a consideration of the average amount of statutory net income distributed by corporations over a period of years. Many witnesses for the opposition have stated that averages are deceptive, and I believe that here we have a particular instance of that. Treasury estimates were based not merely upon a consideration of averages but on a consideration of the particular phase of the business cycle in which we now find ourselves. The proportion of corporation net earnings disbursed as dividends characteristically varies with the different phases of the business cycle--dividend disbursements substantially lagging behind net income, so that they fall behind it during periods of revival and run ahead of it during periods of decline, the net resultant of these variations being the averages which Mr. May and other witnesses have quoted. In estimating the distribution for 1936, the

Treasury has not merely considered past years generally but has studied selected years in the business cycles which are considered most closely analogous with the year 1936. When all is said and done, our best assurance as to the dependability of these estimates is the Treasury's past performance and the record of that is before the Committee.

III

Sections 102 and 351 As Remedies

In the next place, a number of witnesses who have suggested that objectives of this bill might be better attained by a stiffening of sections 102 and 351. I might first note in passing that all these suggestions have been couched in general terms and that no specific and concrete proposal for strengthening these sections has been presented to the Committee. Frankly, I doubt the judgment of the people who advocate this as a real solution, since this Committee knows how great are the difficulties and how sparse have been the results of years of experimentation with these sections.

Even assuming, however, that these sections could have been provided with a real backbone, we would not have attained the objectives of this measure and those who so state, I believe, misunderstand those objectives. As typical of such misunderstandings, let me take Mr. May's classification of all corporations into three groups -- namely, (1) the large group of small corporations which he states do not in any event

constitute a source of tax evasion, (2) the group of corporations, small in number but great in importance, which are publicly owned and whose dividend policies, according to Mr. May, are not at all governed by tax considerations, and finally (3) the small group of large closely-held corporations against which he states the bill is directed. Mr. May compares the bill with Herod's massacre in which there was a great slaughter of innocents in an attempt, ineffectual in that case, to reach a single individual. Likewise, in this case, Mr. May contends there will be a widespread slaughter of innocents--the small corporations and their stockholders and publicly-held corporations and their stockholders--in order to reach a few offenders. Mr. May's analogy is poorly put, for I assure you that there will be no slaughter of innocents if this bill is adopted, and there are many using corporations to avoid surtaxes. Contrary to the supposition of Mr. May and of so many of the witnesses who have appeared in opposition to it, the bill is not directed solely against conscious tax evasion. We are not interested in the motive of tax evasion but in the fact of lost revenue to the Federal Government which occurs when corporation earnings are neither distributed to stockholders and so subjected to the individual income tax, nor subjected to a compensatory tax in the hands of the corporation. Every corporation which would be subject to the proposed tax, those falling in Mr. May's first and second groups equally with those falling in his third, and the incorporated pocketbooks back of any and all of them would be equitably subject to it on this principle, and the contrary impression so widely prevailing among the witnesses who have appeared before this Committee is based upon a complete misapprehension of purposes of the measure.

IV

Does the bill favor the strong against the weak?

Next, I believe that we should take up the allegation urged by practically every witness who has appeared in opposition to it, that this tax would stunt the growth of small and struggling corporations and discriminate against them and in favor of large and well established corporations. I might first call your attention to the fact that, while you have heard a great deal from people who have heard that large and powerful corporations desire this tax in order to stamp out their small competitors, or who have heard of people who have heard of this, no representative of a large corporation appeared before you to advocate this tax. On the other hand, representatives of large and powerful corporations have appeared before you to oppose this tax out of solicitude for their smaller brothers. I am surprised they did not employ the over-worked widows and orphans.

Let us look at the facts. We have urged that corporations, both large and small, can secure such capital as they need for the conduct of their operations by the sale of stock, either to stockholders or others, distribute notes to stockholders or by distribution of optional stock dividends as provided in section 115 of the bill. The stock to be sold to stockholders could, of course, be taken up out of the cash dividends disbursed to such stockholders in an amount equal to the earnings which would have been directly reinvested in the absence of the tax. Mr. Ballantine urges that this proposed methodology is impractical since up to 79% of the dividends so distributed will be taken by the Government in income taxes and so will not be available for resubscription. This is, in

fact, the case to the extent that such dividends fall in income brackets of individual distributees in excess of \$5,000,000, but relatively few small and struggling corporations have principal stockholders whose incomes range to those figures. For most small corporations, the amount which will be available for resubscription would be substantially larger under the proposed plan than under the present law. As a matter of fact, the proposed plan would in this respect give small corporations an advantage which they have never had before. Let me read you in this connection an excerpt from Mr. Haas' statement, which I believe covers the matter very thoroughly:

"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 the principal stockholders in large, prosperous, and well-established corporations. If, therefore, such principal stockholders subscribe back to the corporation for additional shares all or part of their dividend receipts, less the personal income tax thereupon, the proportion of the gross dividend receipts subscribed back by them will be much greater in the case of the average small corporation than in the case of the average large one. The great importance of the difference which exists because of the differing individual income-tax rates upon different income classes can best be seen when it is noted that while dividends which fall in the bracket between \$10,000 and \$12,000 of stockholders' individual incomes will be reduced by only a personal income tax of 11 percent, or less than the present corporation taxes, the dividends which fall in the income bracket between \$100,000 and \$150,000 will be reduced by a 62 percent individual income tax. In other words, a greater proportion of the earnings of small corporations will be available for reinvestment, when paid out to their stockholders, than of large corporations. I submit that this differential will give smaller corporations a chance to catch up upon their larger rivals which they never have had under any previous tax legislation."

So much for the proportion of earnings of small corporations which would be available for reinvestment as compared with the proportion of earnings of large corporations which would be so available. How about the mechanical facility for getting the money back? As long as a corporation is really closely-held, as most small and struggling corporations are, this facility is well-nigh perfect. A year's earnings may be declared in dividends and resubscribed for stock and the whole operation completed in short order. Compare this flexibility, peculiar to the small corporation, with the more cumbersome process by which a large corporation may secure reinvestment in its business of sums disbursed as dividends, and I believe that you will agree that the facility with which small corporations may reach their earnings for additional invested capital under the proposed plan is in no way less than that with respect to large corporations, and that, indeed, the bill insofar as it alters the situation at all, makes lighter the handicap of the small corporation in the race for supremacy.

V.

Coercing Stockholders

Here I should like to touch, in passing, upon the corollary objection that the bill would give an advantage to corporations whose stockholders are able to resubscribe their dividends for additional stock, as compared with corporations whose stockholders are not able

to do this. Note that under the present law the alternative presented is that such sums be directly invested by the corporation, and so not disbursed as dividends at all. What, may I ask, are the circumstances of stockholders who are perfectly able to forego dividends under the present law but, if in receipt of them would be unable to resubscribe them. I submit that this inability must be merely another term for unwillingness; and I submit also that if they are unwilling to resubscribe such dividends then their judgment ought to be and must be final and that it is not the province of the Federal Government to question it. It is safer to let the real owners say whether their funds shall be reinvested in a particular business.

VII

The Principle of Equality

Next, in our presentation before your Committee and before the Ways and Means Committee of the House of Representatives, we have urged that the proposed Act would result in a greater measure of equality of opportunity between the three forms of business organization, i.e., individual proprietorships, partnerships, and corporations, than exists under the present law. Under the present law very small corporations are discriminated against since their net income is taxed at an average rate of approximately 15 to 16 percent, plus the individual income surtax on the amounts of income distributed (provided the recipients thereof fall within the surtax brackets), and this rate of taxation may be greatly in excess of the rate to which the recipients would have been subject had they been operating as individual proprietors or members of partnerships. On the other hand, the present law discriminates very greatly in favor of large corporations since it permits the undistributed portion of their income to escape, with a flat tax of about 16½ percent, while the whole of their income, were it obtained from businesses

conducted as individual proprietorships or partnerships, would be subjected to much higher rates of taxation.

It has been urged that this is unrealistic since in fact the types of business characteristically conducted by individual proprietorships, partnerships, and corporations are quite different, and the three groups are essentially non-competitive. It has been further urged that, insofar as they are competitive, the obvious remedy is for individual proprietorships and partnerships who do not like the discrimination to incorporate.

There is competition. For example, the chain stores are destroying our individual merchant class. But grant there is none, still I do not believe that these objections will stand close scrutiny. The first seems to assume that this Bill aims to achieve tax equality merely between competing concerns. I challenge that. Retail merchants in New York and in California, barbers and makers of misses' dresses may hardly be said to compete, but I have yet to hear it urged that they should, therefore, be subject to differential rates of taxation upon their net incomes. The fact is that our quest for equality in taxation of business income is quite independent of competition, and your Committee would not for a moment listen to a proposal that net incomes derived from some occupations should be taxed at higher rates than those derived from others. Neither do I believe that the gentlemen who have urged this point to your Committee would favor any such proposition.

if the question were put up to them squarely. But such is the inclination of all of us to justify inequities which we find already existing, that there apparently seems to be no inconsistency between suggesting a lack of competition as a justification for taxing the earnings of stockbrokers, and if I may, lawyers, at a higher rate than those of manufacturers of children's rompers.

Let me turn next to the point that any one may escape this discrimination by incorporating. The most obvious reply to this is that it is not the business of government to compel any such thing, granting it would be socially desirable. Moreover, in many cases it simply isn't possible. It is a remedy which is not open, for example, to the legal profession, and I believe that the lawyer members of this Committee will agree with me that it will be a dark day when legislation leads to the incorporation of our law firms in order to fit them into the framework of our tax system. Neither is the device of incorporation open, for example, to members of the New York Stock Exchange.

Arguing more fundamentally, however, and independently of such special cases, are we justified in asking that people adapt the form of organization under which they do business to the single motive of minimizing taxes? The conduct of a private or investment banking business by a partnership constitutes, for example, a real gesture of good faith. It means that each partner in the enterprise is prepared to stake his whole personal fortune upon the safety of the funds entrusted to it and to the integrity of its repre-

sentations and warranties. It also means that he will be subject to income taxes ranging up to 79 percent on the income which he derives from the business as compared with corporation taxes aggregating only about $16\frac{1}{2}$ percent on the income of his competitors who are quite satisfied with the limited liability offered by a corporation. Here the discrimination in favor of the corporation and against the partnership constitutes nothing less than a surtax upon honor, and yet there are still partnerships of great size operating in these fields.

VII

This Bill and Savings

I do not believe that the answers which have been made by the witnesses of the opposition to the constructive case on this point are entitled to carry conviction. Let us look, therefore, to their own constructive case -- to the reasons which they advance why corporation earnings should be taxed at lower rates than if they had accrued to individuals. These reasons, in all of the many forms in which they have recurred throughout the testimony which you have heard during the past two weeks, can be summed up into the general proposition that undistributed corporation earnings represent a form of savings, and that savings ought to be treated with a particular tenderness by the tax collector since they form the stuff from which our country has been built and are the only means by which its progress may continue. There are economists who believe that under present circumstances we are suffering from over-saving rather than under-saving, but let us waive their arguments and go to the

opposite extreme of granting for the moment the point made by these witnesses, i. e., that corporation savings should be accorded special treatment. Do not these gentlemen prove too much? The aspect of this income which is alleged to justify such special treatment is not that it accrues to corporations but that it is designated for saving. If then, we are to accord a preferential tax treatment to funds saved by corporations, we ought equally to accord such treatment to sums saved by individuals. Are you gentlemen willing to go that far, realizing that to do so would completely vitiate the productiveness of the higher brackets of the individual income tax, and force us to raise the great bulk of the revenue for the support of the Federal Government by excises on consumption? The question answers itself.

Recurring then to the main point, if the savings of individuals are not to be accorded special tax treatment, neither should those of corporations, and I believe you will find upon reflection that most of the testimony which has been presented to you with respect to the necessity of according special treatment to those portions of corporation income used for expansion of plant, increase in inventory, repayment of debt, etc., are covered by this general principle.

IX.

BOOMS AND DEPRESSIONS.

An argument upon which opponents of the proposed tax policy, Mr. Noel Sargent for example, have laid considerable stress is that it would tend to intensify both booms and depressions. This undesirable consequence is supposed to result from the effects of increased dividend disbursements in good times and reduced disbursements in bad times upon the course of stock prices. As a matter of fact, common sense may be relied upon to establish just the contrary conclusion. The greater probability is that booms and depressions would be reduced rather than increased in severity as a result of the proposed new tax.

During the '20's the practice of reinvesting a large proportion of corporate earnings led to three notable developments. First, there occurred an excessive expansion of plant and equipment in certain industries, notably in some branches of the building industry. Second, there took place an accumulation of idle surplus funds in the hands of corporations, which reduced the purchasing power necessary to maintain a smooth flow of industrial products. Finally, there was a great increase in corporate loans to the stock market, these loans serving to augment speculation. As a concrete illustration of the accumulation of idle corporate funds during that period, we may cite the increase of \$5.6 billions between 1926 and 1929 in the cash holdings of corporations reporting balance sheets to the Bureau of Internal Revenue. With respect to the financing of stock market speculation, brokers' "loans for the account of others", representing very largely the lending of unneeded corporate reserves, increased from \$600 million in

1926 to \$3,600 million in 1929.

A wider distribution of corporation earnings during this period, in place of so large a volume of reinvestment of earnings, would have served to reduce the force of each of these three causes of over-expansion and speculation. Moreover, to the extent to which additional dividends were spent for consumers' goods, wholesome industrial activity would have been more amply sustained.

X.

Regimentation

Some of our witnesses lay considerable store by the charge that the proposed tax is a step in the direction of Government regulation and regimentation of business corporations. Mr. Noel Sargent in particular makes this assertion, on the ground that the tax "sets up a basic standard amount which should be retained as reserves and puts a tax penalty upon reserves beyond such arbitrary fixed standards." This argument will scarcely bear examination. The low corporate surtax rates on the first 30 to 40 per cent of reinvested income permit a moderate and reasonable use of this method of raising capital. If more is needed there are many other means of raising it, to some of which I have earlier referred in some detail. In view of these various and simple methods of increasing the capital of a corporation, it is to say the least an exaggeration to claim that the proposed tax involves "regimentation" and "planning".

If the bill has the effect of bringing about a greater distribution of dividends, it will have the result, not as Mr. Sargent says--of "substituting Government discretion for that of management as to the amount of earnings which should be retained in the business," but of substituting the discretion of the actual owners of corporations, their stockholders, for that of their directors. So far as this might be accomplished, the effect of the bill would be democratic rather than autocratic, in the direction of a more liberal, rather than of a regimented economy.

[UNREVISED PRINT]
REVENUE ACT, 1936

HEARINGS
BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE
SEVENTY-FOURTH CONGRESS
SECOND SESSION
ON
H. R. 12395
AN ACT TO PROVIDE REVENUE, EQUALIZE TAXATION
AND FOR OTHER PURPOSES

PART 9

MAY 12, 1936

Halluc

Oliphant - H. R.

Printed for the use of the Committee on Finance



UNITED STATES
GOVERNMENT PRINTING OFFICE
WASHINGTON : 1936

UNREVISED PRINT
REVENUE ACT, 1938

HEARINGS
BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE

COMMITTEE ON FINANCE

PAT HARRISON, Mississippi, Chairman

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| JOSEPH F. GUFFEY, Pennsylvania | |

FELTON M. JOHNSTON, Clerk

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REVENUE ACT, 1936

TUESDAY, MAY 12, 1936

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

The committee met, pursuant to adjournment, at 10 a. m., in the committee room, Senate Office Building, Senator Pat Harrison presiding.

Present: Senators Harrison (chairman), King, George, Walsh, Barkley, Connally, Bailey, Clark, Byrd, Lonergan, Black, Gerry, Guffey, Couzens, Keyes, La Follette, Metcalf, Hastings, and Capper.

Also present: Herman Oliphant, General Counsel for the Treasury Department; Guy T. Helvering, Commissioner of Internal Revenue; George C. Haas, Director of Research and Statistics, Treasury Department; C. E. Turney, Assistant General Counsel for the Treasury Department; L. H. Parker, Chief of Staff, Joint Committee on Internal Revenue Taxation, and members of his staff; Prew Savoy, special attorney, Department of Agriculture.

The CHAIRMAN. The committee will be in order.

Senator BYRD. Mr. Chairman, I offer this resolution:

The Secretary of the Treasury is hereby requested to furnish a list of all corporations for the tax year of 1935 that had a net income, before Federal taxes, of more than a million dollars, and, based upon the actual distributions of that year, would receive a tax reduction under the pending bill:

- (a) The amount of such reduction of such corporations.
- (b) The rate of taxation if any that would be paid by such corporations in the event the pending bill was then in effect.

This is practically the same request that I made in a letter to the Secretary.

The CHAIRMAN. Does that include in it the request of Senator Black?

Senator LA FOLLETTE. That ought to be in there.

Senator BYRD. Senator Black will have to get up his own.

The CHAIRMAN. Here is a letter that I wrote to the Secretary of the Treasury yesterday. I had overlooked the fact as to the provision of the law limiting the disclosure of such information except as indicated in the statute.

The letter is as follows:

MAY 11, 1936.

HON. HENRY MORGENTHAU, JR.,
Secretary of the Treasury, Washington, D. C.

DEAR MR. SECRETARY: At the executive session meeting of the Finance Committee held today, requests for certain information to be obtained from income-tax returns were made by members of the committee. These requests met with the approval of the committee, and therefore, in behalf of the committee I would ask for the following information:

First, I would request the information as set forth in a letter addressed to you by Senator Harry F. Byrd under date of May 8, 1935, a copy of which is attached hereto.

I would also ask that you furnish the committee a list of our larger individual taxpayers by name who own stock in corporations, showing as far as possible the amount of dividends actually received and the amount of dividends in addition which they would have received if the principal corporations in which they owned stock had distributed all of their net income in dividends. In respect to these individuals, it is requested that the names of these principal corporations be shown and the amount of net income and dividend payments made by such corporations. For the purpose of tax computation, the total income of these larger individual stockholders should also be shown. It is suggested that in connection with these large income taxpayers, you show in one column the amount of tax actually paid by the corporation on the profits which constituted their part of the corporate earnings as compared with the amount of tax that these individuals would have been required to pay on the same profits, if they had been received by them indirectly as dividends distributed.

Mr. Kent, Acting Chief Counsel of the Bureau of Internal Revenue, was present during the discussion this morning, and can undoubtedly give you a more detailed analysis of the information requested. It appears that under section 257 (b) of the Revenue Act of 1926, this information may properly be submitted to the committee in executive session.

Sincerely yours,

(The enclosure referred to is as follows:)

HON. HENRY MORGENTHAU, Jr.,

Secretary of the Treasury, Washington, D. C.

MAY 8, 1935.

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 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 (now pay 15 percent)

| Company | Net income after tax | Dividends paid out |
|----------------------------------|----------------------|--------------------|
| American Telephone and Telegraph | \$121,745,729 | \$167,993,473 |
| American Tobacco Co. | 24,084,280 | 26,590,856 |
| American Smelting & Refining | 7,563,202 | 7,878,000 |
| General Electric Co. | 19,726,044 | 19,881,452 |
| Goodyear Tire & Rubber Co. | 4,287,664 | 4,508,007 |
| International Harvester | 3,946,637 | 8,284,049 |
| National Biscuit Co. | 11,597,673 | 19,310,342 |
| National Dairy Products Co. | 5,351,930 | 8,197,573 |
| Ohio Oil Co. | 5,411,924 | 8,294,728 |
| R. J. Reynolds Tobacco Co. | 21,538,894 | 30,000,000 |
| Texas Co. | 5,545,305 | 9,344,820 |

The above list of financially strong companies that can completely avoid taxation can be greatly expanded.

Corporations which would pay less than 5 percent

| Company | Net income after tax | Dividends paid out | Tax under new bill (percent) |
|-----------------------------------|----------------------|--------------------|------------------------------|
| Air Reduction | \$5,145,410 | \$5,727,142 | 2.85 |
| Allied Chemical & Dye Corporation | 17,569,855 | 15,704,874 | 3.10 |
| Corn Products Refining Co. | 9,702,605 | 9,394,750 | 1.20 |
| Curtis Publishing Co. | 5,895,720 | 6,499,000 | 3.40 |
| E. I. du Pont | 45,701,465 | 46,788,914 | 3.30 |
| Firestone Tire & Rubber | 4,154,656 | 5,572,199 | 2.00 |
| General Foods | 11,243,876 | 8,422,614 | 4.40 |
| Great Western Sugar | 5,761,797 | 5,370,000 | 1.55 |
| Imperial Oil Co. | 14,161,561 | 13,416,169 | 1.46 |
| Liggett & Myers Tobacco Co. | 20,086,591 | 17,300,577 | 4.18 |
| Parke, Davis & Co. | 3,713,368 | 5,212,480 | 1.50 |
| Pennsylvania Railroad Co. | 19,377,839 | 13,518,946 | 3.00 |
| United States Smelting & Refining | 8,052,968 | 6,000,129 | 2.50 |

Corporations which would pay less than 10 percent

| Company | Net income after tax | Dividends paid out | Tax under new bill (percent) |
|----------------------------------|----------------------|--------------------|------------------------------|
| American Can Co. | 19,592,946 | 15,226,321 | 6.63 |
| Armour and Co. (Delaware) | 8,225,825 | 5,599,650 | 8.54 |
| Eastman Kodak Co. | 14,503,247 | 10,499,080 | 8.54 |
| General Motors | 94,799,121 | 73,621,710 | 6.78 |
| Great Atlantic & Pacific Tea Co. | 20,478,196 | 15,430,796 | 6.72 |
| International Shoe Co. | 8,967,024 | 6,671,742 | 7.78 |
| J. C. Penney Co. | 16,147,315 | 11,307,108 | 9.37 |
| Phillips Petroleum Co. | 5,737,209 | 4,153,998 | 8.30 |
| Procter & Gamble | 14,870,957 | 10,512,866 | 8.30 |
| Socony-Vacuum Oil Co. | 24,121,297 | 18,632,661 | 9.50 |
| Standard Oil Co.: | | | |
| California | 18,247,607 | 13,068,479 | 8.99 |
| Indiana | 18,940,640 | 13,371,229 | 9.61 |
| New Jersey | 67,882,271 | 54,264,183 | 6.10 |
| Texas Quit Sulphur Co. | 5,616,470 | 5,720,000 | 3.22 |
| United Fruit Co. | 12,049,200 | 8,717,080 | 8.99 |
| F. W. Woolworth Co. | 32,142,393 | 25,288,679 | 8.34 |

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 50 percent 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 reemployment 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,

HARRY F. BYRD.

Senator BYRD. This makes some slight change in the request that I made. I want the amount of reduction of each corporation, which my letter did not specifically ask for.

Senator LA FOLLETTE. It would seem to me, Mr. Chairman, in view of your letter, which seems to me to cover Senator Black's request, that we could pass Senator Byrd's resolution which asks for a little additional information than that requested in your letter to the Secretary.

The CHAIRMAN. Without objection, this resolution will be adopted, and the clerk will transmit it immediately just as it is adopted to the Secretary of the Treasury, requesting him to comply with it.

SENATOR BARKLEY. Is there any question that the letter carries with it the effects of the resolution? Whatever we do ought to be in the one resolution, and not parts of piecemeal resolutions.

THE CHAIRMAN. Yesterday there was no resolution passed. I took it as the action of the committee. The law says it can be furnished when the committee requests it.

SENATOR BARKLEY. Was it not your intention that your letter should cover both these informations sought by Senator Byrd and Senator Black?

THE CHAIRMAN. Yes. This letter went yesterday to the Secretary of the Treasury. This is some additional information that Senator Byrd desires, so we will send another letter.

SENATOR BARKLEY. I do not object to it, but I think if we are going to pass a formal resolution asking for information, it ought to ask for all of the information that we want.

SENATOR LA FOLLETTE. Would it not satisfy the situation to propose that the committee authorize and endorse the letter which the Senator transmitted to the Secretary, as expressing the action of the committee?

SENATOR BYRD. A separate motion?

THE CHAIRMAN. Yes.

SENATOR LA FOLLETTE. I move then that the committee express its approval of the letter which the chairman has written to the Secretary of the Treasury as embodying and expressing the action taken by the committee on yesterday.

SENATOR CLARK. I second the motion.

THE CHAIRMAN. Without objection, the motion will be adopted.

SENATOR BYRD. Then the motion that I made is adopted too?

THE CHAIRMAN. That is adopted, and a letter will be sent immediately for that information.

The Secretary of Agriculture is here, and I request you, Mr. Secretary, to come forward and make such statement as you desire.

STATEMENT OF HON. HENRY A. WALLACE, SECRETARY OF AGRICULTURE

Mr. WALLACE. As you are aware, I have sent you a memorandum in the form of a letter which I think you have before you, and I believe all of the members of the committee have mimeograph copies of this letter. I suspect that the most orderly method of procedure would be for me to read this letter:

"MAY 7, 1936.

"HON. PAT HARRISON,
"United States Senate.

"MY DEAR SENATOR: I wish to thank you and the members of your committee for this opportunity to express my views and the views of the Department of Agriculture with respect to such portions of the pending tax bill (H. R. 12395), and such further related matters as are of direct interest to this department.

"I refer, first, to the provisions for a tax of 90 percent on income which constitutes an unjust enrichment of processors resulting from the nonpayment of processing taxes growing out of the decisions of the Supreme Court in the *Hoosac Mills and Rice Millers cases*; second,

to provisions which I shall suggest intended to insure the retention of the \$903,229,981.67, collected as processing and related taxes under the Agricultural Adjustment Act in all cases where the taxpayer did not bear the burden of the tax; and, third, to the levying of excise taxes at moderate rates on the processing of certain agricultural commodities.

"I wish to endorse strongly the inclusion of the bill of provisions looking to these ends: The first, on the ground that with rare exceptions the processors did not absorb the processing taxes, but passed them on to consumers or back to producers, and that hence the approximately 320 million dollars of impounded and otherwise uncollected taxes, lost by the Government as a result of the Supreme Court's decisions, represent an unjust enrichment or outright gift which should be recovered by the Treasury; the second, on the ground that, where the taxpayer did not sustain the economic burden of the tax, he should not recover the taxes paid, for the same reasons which justify a tax on the net income resulting from nonpayment of such tax; and the third, on the ground that agriculture has a profound interest in the maintenance of the Federal Government's revenues and in the production of a part of such revenues from sources having some relationship to agriculture."

I discuss now the tax on unjust enrichment:

"The decision of the United States Supreme Court in the *Rice Millers' case* returning impounded processing taxes to processors resulted in a loss to the Federal Government of approximately 320 million dollars in impounded or otherwise uncollected taxes.

"Processors' margin, during the period the processing taxes were in effect, were widened in practically all cases to include the tax. This means that the tax was passed on to the consumers or back to the producers and was reflected in market prices up to January 6. The processors therefore are absolutely not entitled to keep for themselves tax revenues which have already been paid to them by consumers and producers. To allow the processors to retain this revenue would be in the nature of a sheer gift which, for example, for the cotton, wheat, and hog processing industries would amount to several times their annual net profits of prosperity years.

"I am aware that the large meat packers have recently been agitating against the 'windfall' tax provisions on the ground that these provisions for a tax of 80 percent on unjust enrichment from this source would be unfair to small packers.

"I wish to point out that the lion's share of the tax gift will go, not to the small packers, but to the big packers, if they should succeed in defeating the 'windfall' tax provisions. Ten large packers alone were enriched by about 50 million dollars of unpaid taxes, or half the total unpaid hog taxes. This sum is probably four times these packers' 1935 earnings from hog operations. The processors' margin on hogs was widened to include the tax by large and small processors alike. This is much different than saying that there were no small packers who lost money. Some of them did. Small packers were bound to have difficulty following the sharp reduction in hog supplies caused by drought. They are always hard pressed by larger competitors in periods of falling hog supplies and rising hog prices. The fact of size, however, would not seem to justify the application of a different principle in the matter of unjust enrichment.

"That the real interest of the few big packers in their opposition to the 'windfall' tax is not the small packer but the enormous unearned enrichment to themselves, is further revealed by the volume of hogs slaughtered by them and by the small packers. During the fiscal year 1935, there were 16,627 hog processors. Four large packers slaughtered 40 percent of all hogs, 10 additional packers slaughtered 24 percent of the total, and 32 additional packers slaughtered 17 percent of the total. These 46 packers slaughtered 81 percent of all the taxable hogs slaughtered in 1934-35."

Senator CLARK. How many packers are there in the United States, Mr. Secretary?

Mr. WALLACE. There are 16,627 hog processors. Of course, there are other packers that deal in cattle.

Senator CLARK. And 46 packers slaughtered 81 percent of all of the hogs?

Mr. WALLACE. Yes.

Senator CONNALLY. Mr. Secretary, does that include small butchers or is that real packing plants, the 16,000?

Mr. WALLACE. I think this includes all hog processors, however small. That is all that would be reached by the Bureau of Internal Revenue.

Senator BARKLEY. How many of what you call packers are in the packing business in the whole country? Do you know and can you give the figure?

Mr. WALLACE. That is a matter of definition, and it would be impossible for me to give you a definite answer.

Senator BARKLEY. Forty-six would be a small proportion of the total number engaged in the hog-packing business, would it not?

Mr. WALLACE. Yes; although the 46 did 81 percent of the business.

Senator BARKLEY. That would be a small percentage?

Mr. WALLACE. Yes; that would be a small percentage.

Senator COUZENS. Mr. Secretary, I would like to ask how you arrive at this conclusion: "Small packers were bound to have difficulty following the sharp reduction in the hog supplies caused by the drought." Do I understand that you mean the committee to understand that was the only cause for the hog supplies to be short?

Mr. WALLACE. It is always a matter of past history as you study packing earnings, that whenever hog prices go up and hog supplies go down, the big packers, perhaps because of the inventory carried over from the preceding period of low hog prices, the small packers not being in a position of carrying such large inventories, find themselves in a difficult competitive position.

Senator COUZENS. I understand that, but you say impliedly that the only cause was the drought. Was there not another cause?

Mr. WALLACE. You are referring to the Agricultural Adjustment operations?

Senator COUZENS. No. You say "Small packers were bound to have difficulty following the sharp reduction in hog supplies caused by the drought." Was there another cause for the small supply?

Mr. WALLACE. I say, you are referring to the Agricultural Adjustment operations, are you not?

Senator COUZENS. That is what you are talking about, is it not?

Mr. WALLACE. The dominating factor in the great scarcity of hogs was the extraordinary drought. If there had been no Agricultural

Adjustment operations whatever, there would have been, I suspect, the way things turned, almost as great a reduction as there was.

There were three causes for the very pronounced condition. One was the extraordinary short corn crop of 1934; second, the extraordinarily low hog prices of 1933 and early 1934 to which there is always something of a reaction; and, third, the fact that we had definitely endeavored under the Agricultural Adjustment program, to bring about a sufficient reduction in hogs so that there would no longer be a large supply to place on the market.

Senator COUZENS. What percentage of the shortage was attributable to that last classification?

Mr. WALLACE. I am unable to state definitely at this time, although we have made a definite estimate of that and can give you the figure.

Senator COUZENS. If these small packers processing some 19 percent of the whole, lost money, how are they going to return or pay to the Government this unjust enrichment money if they did not get it?

Mr. WALLACE. They got the money, all right.

Senator COUZENS. If the lost money and have no money to pay this unjust enrichment which you allege, how are they going to pay this unjust enrichment money? In other words, there is plenty of evidence before the committee to indicate that among this 19 percent of the hog processors who made no money, they have no money to pay this unjust enrichment tax. How are they going to do it?

Senator KING. Go into bankruptcy, if they are not already there?

Senator COUZENS. This is a serious situation.

Mr. WALLACE. That kind of a situation has happened in the Bureau of Internal Revenue again and again.

Senator COUZENS. What do you mean? That they pay a tax on money that they did not earn?

Mr. WALLACE. I mean to say that there have been many small concerns that have found themselves in a position unable to pay the taxes which were owing to the Government.

Senator COUZENS. What taxes?

Mr. WALLACE. Income taxes.

Senator COUZENS. They do not have to pay any if they do not make any, so they cannot have any experience along that line.

Mr. WALLACE. Oh, yes, they can.

Senator COUZENS. How?

Mr. WALLACE. They can find the experience in the succeeding years so difficult that they are unable to pay, although they expected to be able to pay as the result of the preceding year's operations.

Senator BARKLEY. If after collecting these processing taxes and not turning them into the Treasury, they are in a big fix, how much worse fix would they be in if they had not collected the taxes?

Mr. WALLACE. The point I would make, answering your question somewhat indirectly is that these men would have been, if there had been no processing tax whatever, if there had been no Agricultural Adjustment program whatever, that these men would have, so far as their operations are concerned, would have been in a position of less just the same.

Senator COUZENS. You say no, just the same. That is the point I am trying to make. If it is just the same, then why the return of the enrichment money that they did not collect or did not get, be-

cause their business showed a loss? You say it would be just the same if we had the Adjustment Act or not.

Mr. WALLACE. This is the point I would make Senator; that the small packer as well as the large packer, widened the margin between the paying prices to the farmers and the selling prices to the consumers.

Senator KING. That is, they paid more for their products, you mean?

Mr. WALLACE. No. Small packers to some extent, we will say, paid less for their hogs and charged the consumer more for the product.

Senator KING. The evidence before us shows, by these small packers, that they were compelled to pay advancing prices largely because of the limited production because of your policy of killing the pigs and restricting production, and they were compelled to pay higher prices than they otherwise would, and the evidence before us shows an enormous advance in prices which they had to pay for the hogs.

Mr. WALLACE. Senator, the point I was making was dealing with the incidence of the processing tax itself, with the margin. I am not dealing with the absolute price of hogs, but the margin between what the packers paid to the farmer and what they sell the product for to the consumer. The point I was making was the fact that the small packers like the large packers widened that margin, in part by paying a lower price than these farmers—

Senator BARKLEY (interposing). As the price went up due to whatever cause brought it about, whether it was from drought or from the Agricultural Adjustment, or for any other reason, as the price of hogs went up, the margin of difference between the price paid the producer and the price charged the consumer, maintained its status? It did not vary because the price went up, so that that width was maintained, the higher the price went, would it not?

Mr. WALLACE. In general that is correct, although there is a tendency, just going back over the years before the Agricultural Adjustment, there is a tendency, I believe, in times of rising prices, because of the superior competitive position of the large packers, to reduce that margin a little bit when hog prices are going up, because they have that inventory to enable them to out-compete the smaller packers. There is a tendency to reduce the margin in times of rising prices.

Senator BARKLEY. They carry over stocks for which they had paid a lower price, and that enables them to reduce the margin a little bit?

Mr. WALLACE. Yes.

Senator CONNALLY. As I understood you a little while ago, if there had been no processing tax on, the demand for pork products would have been higher to the producer than they would have been probably if otherwise with the tax on; in other words, the added expense of the tax had a depressing effect on the price to the producers. When that tax was added, the processors wherever they could, did pass that on and thereby created the spread that you speak of?

Mr. WALLACE. Yes; he passed it on. There were only two ways that he could pass it on; one was charging more to the consumer, and the other was passing less to the farmer.

Senator CONNALLY. And the fact that it was on, would give him an advantage in paying a little less to the farmer, because all prices have a certain reaction to demand, and the natural demand for hogs adjusted by the price with the tax on, might have justified, like that same price if there had been no tax on to the producer, competition with other meats and other food products.

The CHAIRMAN. All right, Mr. Secretary, will you proceed?

Mr. WALLACE. "The total tax liability on hogs slaughtered in that year was \$174,000,000. Of this amount, the 4 largest packers owed the Treasury \$69,000,000; the next 10 largest packers, \$36,000,000; and the next 32 largest packers, \$30,000,000. These 46 large firms incurred a tax liability of \$135,000,000 out of a total of \$174,000,000, or an average of \$3,000,000 per taxpayer. The balance of less than \$40,000,000 covers the slaughter operations of over 16,500 hog processors, or an average of \$2,400 per taxpayer. The four largest packers collected in processing taxes in the 1935 fiscal year about four times the annual net profits of the entire meat-packing industry in prosperity years.

"Representatives of the meat packers are publicly on record, including statements made in testifying before committees of Congress, to the effect that they pass the processing taxes back to the farmers. Such statements are to be found, among other places, in the hearings relating to the Agricultural Adjustment program before the Committee on Agriculture of the House of Representatives, Seventy-second Congress, second session, pages 232 and 268, hearing on H. R. 5585, before that committee, during the Seventy-fourth Congress, first session, page 253, and in the hearings on S. 1807, before the Senate Committee on Agriculture and Forestry, Seventy-fourth Congress, first session, pages 183-188. Their present assertions that they now have a just claim to this money are indeed inconsistent with their prior statements and with the true facts.

"The Hoosac Mills and Rice Millers' decisions destroyed the self-liquidating nature of the Agricultural programs.

"The losses of revenue which these decisions caused the Government, totaling, as I have said, in excess of \$320,000,000 in unpaid taxes, have made new tax legislation essential.

"Farmers who as producers and consumers contributed a share of all processing taxes are, I believe, overwhelmingly in favor of enactment of the 'windfall' tax provisions. I feel also that the principle of the Revenue Act of 1919, following the World War, that the Federal Government might properly tax at high rates (graduated up to 85 percent) the usual income derived from war contracts with the Government, sustained in *Hoe & Co. v. Commissioner* (30 Fed. (2d) 630), is equally applicable to the facts presented by the type of 'windfall' income which is the subject of the 'windfall' tax and should be sustained in court now."

The next subject for discussion is the limitation on refunds of processing taxes collected, which has to do with the proposed modification of section 21 (d).

Senator COUZENS. You mean section 21 (d) of the A. A. A.?

Mr. WALLACE. Of the amendments to the agricultural program.

The three departments, Agriculture, Justice, and Treasury, have been in conference on this. They are not in quite complete accord as to certain methods of procedure, although all are agreed that the provision should be rewritten.

The CHAIRMAN. Do you recommend a provision being placed in here modifying that law or changing that law?

Mr. WALLACE. Yes; that was the modification of that section. That was the view of Agriculture. I believe Justice has somewhat the same view. I believe Mr. Oliphant is here and will present a somewhat different view with regard to it.

The CHAIRMAN. But you all are not in accord on that proposition?

Mr. WALLACE. I think that Justice and Agriculture are in substantial accord. I think that the Treasury has a different procedure in mind. I have talked with the Secretary about it, and we have agreed that we would.

Senator BARKLEY. Is there a difference in policy or principle or in the procedure?

Mr. WALLACE. It is a difference in procedure, I would say.

Senator KING. Are you relating to the past, or to the future?

Mr. WALLACE. Relating to the future.

Senator KING. For a continuation of this processing tax?

Mr. WALLACE. No. This is dealing with another matter. I am bringing up another matter having to do with a modification of section 21(d) concerning which modification in principle, all three departments are in accord. This provides that section 21(d) must be rewritten to make it more specific, but as to the exact method of procedure, there is something of a difference as to the best way to go about it. A very amicable difference.

Senator CLARK. Is that section 21(d) of the A. A. A. amendments?

Mr. WALLACE. Yes, sir. Now, I will discuss that particular point.

In addition to the question of the 'windfall' taxes to prevent the unjust enrichment of the processors, referred to, an even larger problem is the question of establishing adequate procedure for handling claims for the refund of the processing taxes actually paid into the Federal treasury. Processing taxes alone, paid during the time the tax was in effect, totaled \$852,382,985. When the other invalidated taxes imposed under the Agricultural Adjustment Act are added, the total sum involved is increased to \$963,229,981.67. Obviously, if these sums, or any large proportion of them were refunded, there would be a very heavy additional burden on the Public Treasury. The problem of equitable procedure with reference to claims for refund in connection with these taxes is therefore an exceedingly serious one.

In the amendments to the Agricultural Adjustment Act approved last fall (Public 320, sec. 21 (d)), an attempt was made to cover this problem. This provision adopted prior to the Hoosac Mills decision, is believed to be inadequate to deal with the problem. To the present date over 8,500 claims for refund have been filed with the Commissioner of Internal Revenue, and over 200 suits have been filed in courts to recover such taxes from the collectors. One district court has held the provisions of section 21 (d) to be invalid.

Attention is called to the fact that the provisions of 21 (d) are being attacked in the courts on the following grounds:

"1. Although it states the conditions under which the Commissioner of Internal Revenue may deny the refund of the taxes paid, it does not establish positive conditions compliance with which shall entitle the claimant to the refund of the taxes. It is argued from this assertion that the provisions are so vague and general as not to give an adequate remedy. The district court in the case mentioned

adopted this view. It may be added that this was one of the main arguments advanced in the Rice Millers case.

"2. The existing language provides no specific period of time within which the Commissioner must act on claims filed with him. Therefore, the claimants allege that the Commissioner could defer action until after the statute of limitations has run and they would then have no recourse to the courts. In some cases the time for the bringing of suit will soon expire. They contend that this denies them due process of law. Undoubtedly, this fact would be sufficient for the courts to take jurisdiction, and the requirements of section 21 (d) would become meaningless.

"3. Under the existing language, the procedure is not carefully worked out as to the precise way in which the claims are to be handled. For example, if a lower court should find that the Commissioner was in error, it does not show clearly what the subsequent steps would be, that is, whether the case would be returned for further findings or whether the court would render a final decision.

"It is suggested that it is rather cumbersome to require hearings on each claim, even in cases where the Commissioner decides that the claimant is entitled to the refund. Such hearings are now required.

"These difficulties with the existing provisions, if the courts adopt the view of the claimants, are so serious as to indicate that, if the language is not revised, the Government may be forced to refund the major part of the taxes collected under the Agricultural Adjustment Act (as already indicated, nearly 1 billion dollars in total) regardless of the equities involved. Accordingly, we believe it essential that the existing language of 21 (d) be so revised as to meet the difficulties enumerated, particularly in the matter of giving to processors a clear and positive indication of what they need to show in order to be entitled to a refund of the taxes.

"The suggested amendment is based on the fundamental principle that the processors should be entitled to a refund of the taxes illegally collected only in those cases and to the extent that they themselves actually bore the burden of the tax. Where the burden of the tax was actually passed on to ultimate consumers or back to producers, there is no method by which the tax could be refunded to the person who ultimately bore the burden of the tax, and to provide in such cases for refunded to the persons who paid the tax in the first instance would simply result in unjust enrichment on a scale even larger than that involved to date in the return of the impounded funds."

Senator CONNALLY. Mr. Secretary, may I interrupt you there for a moment? Where the tax is passed on to the consumer, it is an easier problem than where it is passed back to the producer. How are you going to determine whether it was passed back to the producer or not? Is that not largely a matter of speculation?

Secretary WALLACE. Of course, the method which we are proposing here would not involve distributing money either to the consumer or to the producer.

Senator CONNALLY. I understand that, but you say here just a moment ago where the burden of the tax was actually passed on to the ultimate consumer or back to producers.

Mr. WALLACE. Yes.

Senator CONNALLY. I am for your principle that you are standing for, but it is a difficult thing to provide a method of arriving at whether they passed it back to the producer.

Secretary WALLACE. But that does not enter into the procedure we are advocating. The procedure we are advocating is that the Treasury be protected from returning any of this vast sum of money, amounting nearly to a billion dollars to processors. If the money is not returned to the processors, then it does not become a matter of practical concern as to whether the money belongs to the producers on the one hand or to the consumers on the other. There is no need for precise measurement.

Senator CLARK. Is it your contention, Mr. Secretary, that what you are advocating here is that if a processor could show that he had not passed on the tax, that he should not be liable for the tax?

Mr. WALLACE. We are still standing for a principle in this procedure that if such a showing can be made, then the processor might recover.

Senator COUZENS. There is one point raised by Senator Connally that I do not think you have answered completely. That is how, in arriving at a refund, you can determine that a certain amount of it went back to the producer? I do not see how you can arrive at that.

Mr. WALLACE. Well, it is just being stated here in passing. If you want me to discuss that—I think it is off the main channel of thought, but if you want me to discuss that—

Senator COUZENS (interposing). I thought that two factors went into it; one, that it was paid by the processor, and the other that it was passed on to the consumer.

Mr. WALLACE. What enters into the computation of the refund is the total margin between what was paid to the producer and what was charged to the consumer. It is not necessary for the purpose of the principle which I am advocating here to see how much of that increased margin came out of the reduced price to the producer and how much came out of the increased price to the consumer. That is not necessary for the principle which I am working with here. It is a matter on which work has been done, but it is not a matter of practical consideration.

Senator BARKLEY. In other words, it is immaterial which way it passed, but he must show that it did not pass in either direction in order to recover?

Mr. WALLACE. That is right.

Senator GEORGE. Suppose he did not pass back to the producer but a fraction, it would become material.

Mr. WALLACE. If you will allow me to complete the reading of this part, I think you will discover that that particular part is covered. If this increased margin above the normal margin represented only a small portion of the processing tax, then it will be possible under the procedure set up here for the processor to obtain the refund.

Senator GEORGE. I did not know that you had dealt with it.

Senator KING. Was the price paid for the hogs the same in every part of the United States?

Mr. WALLACE. Certainly not. The price paid for hogs varies greatly according to the freight rates and the nearness to the market.

Senator KING. Then how could you determine—I am intrigued with that suggestion of a possible passing of part of it back to the producer. How could you do that? How could you determine whether

the processor had passed any of it back to the producer or whether it had all gone to the consumer?

Mr. WALLACE. That is an immaterial point for the purpose of the discussion. I am merely saying that we can determine—here is the increased margin. It went either back to the producer or it went on to the consumer, or it went a little of each; but for practical purposes, we are not concerned which way it did, but we can say that here is the total amount.

The suggested amendment is based on the fundamental principle that the processors should be entitled to a refund of the taxes illegally collected only in those cases and to the extent that they themselves actually bore the burden of the tax. Where the burden of the tax was actually passed on to ultimate consumers or back to producers, there is no method by which the tax could be refunded to the person who ultimately bore the burden of the tax, and to provide in such cases for refunds to the persons who paid the tax in the first instance would simply result in unjust enrichment on a scale even larger than that involved to date in the return of the impounded funds. This principle that refunds should be made only to the extent to which the burden of the tax was actually borne by the person claiming the refund is that which was enunciated by Congress in adopting section 21 (d) last fall. The suggested language would make it much more specific and lays down a definite rule for the showing that processors must make in order to indicate their right to the refund under this general theory. The suggestions of this Department are contained in the proposed amendment numbered '(3)', Appendix I."

I think you have it, Senator Harrison.

Senator KING. My appendix apparently is eliminated.

Senator COUZENS. We can take up that, can we not?

Mr. WALLACE. It is described in rather simple fashion in the part which I will now read.

The CHAIRMAN. Suppose I put that in the record in this connection. (The matter referred to is as follows:)

APPENDIX I

(1) Page 230, line 2, strike out the period following the figures "1935" and insert in lieu thereof a semicolon and the following: "Provided, however, That in the case of articles other than direct-consumption sugar processed wholly or partly from sugar with respect to which a processing tax was paid, which are exported or delivered for charitable distribution or use, the exportation or the delivery for charitable distribution or use may take place at any time prior to September 1, 1936."

(2) Page 230, line 5, strike out the period following the word "based" and insert in lieu thereof a comma and the following: "and no such refund shall be allowed to any person unless he shall establish that the amount claimed has not been, and will not be, repaid to him by the processor or other vendor, under the terms of any existing agreement. No claim under this section (except a claim under the proviso contained in subsection (a)) shall be disallowed on the ground that the tax, with respect to the article or the commodity from which processed, has not been paid."

(3) Page 233, immediately following line 25, insert the following new section: Sec. 603. The Agricultural Adjustment Act, as amended, is amended by striking out section 21 (d) and inserting in lieu thereof the following:

"(d) (1) As used in this subsection 21 (d)

"(A) 'Commodity' means any commodity, prior to processing, of a type with respect to which a processing tax was imposed under the provisions of this title, or would have been imposed had it been processed in the United States (as defined in section 10 (f) of this title) during the period in which the tax was in effect.

"(B) 'Article' means the product which is obtained by processing the commodity, and includes the goods obtained by any further manufacture or by combination with other materials, whether the manufacture or combination be done by the processor or another.

"(C) 'Claimant' means any taxpayer who has filed with the Commissioner a claim for refund of processing, floor stocks, or import compensating taxes paid under this title.

"(D) 'Affiliate' means a corporation a majority of the voting or unlimited dividend stock of which is owned or controlled by the claimant, or which owns or controls a majority of such stock of the claimant, or a majority of the voting or unlimited dividend stock of which is owned or controlled by the same interests which own or control a majority of such stock of the claimant. As used in this subdivision, 'corporation' includes an association, trust and any other business organization, and 'stock' includes certificates and any other evidence of beneficial interest.

"(E) 'Commissioner' means the Commissioner of Internal Revenue.

"(F) 'Processing tax' means the tax imposed by this title upon the processing of a commodity which at the time of processing was owned by the processor or an affiliate.

"(G) 'Custom-processing tax' means the tax imposed by this title upon the processing of a commodity which at the time of processing was not owned by the processor or an affiliate, but was processed for a customer.

"(2) No suit, action, motion, or proceeding of any nature, whether brought before or after the date of enactment of this amendment, shall be entertained by, or maintained in, any court for the recovery, recoupment, set-off, refund, or credit of, or counterclaim for, or review of a customs protest against, any amount of any tax, penalty or interest, which was imposed or accrued under this title, unless subsequent to the date of the adoption of this amendment and prior to January 1, 1937, a claim for refund of such tax, penalty or interest has been filed with the Commissioner; and after filing such claim suit may be brought only as provided in subdivisions (7) and (8) of this subsection (d).

"(3) No claim shall be considered by the Commissioner for, and no recovery, recoupment, set-off, refund, credit, or counterclaim shall be made or allowed to any claimant of, the amount of any such tax which has been heretofore refunded or credited by the Commissioner to such claimant under the provisions of subsection (a) or (c) of section 15, section 16, or section 17 of this title, or otherwise refunded or credited to such person.

"(4) (A) No claimant shall file more than one claim relating, respectively, to processing taxes, custom-processing taxes, or floor-stocks taxes, paid with respect to a single commodity. Claims relating to import compensating taxes shall be in such number as the Commissioner may prescribe.

"(B) Such claim and any amendment thereof shall be under oath and shall contain such information and be in such form as the Commissioner, with the approval of the Secretary of the Treasury, shall prescribe by regulation. The Commissioner is authorized to require, at any time in the course of the proceedings before him, such additional information under oath as he shall deem material or relevant to consideration of the claim. The Commissioner is authorized to disallow any claim because of failure by the claimant to supply any information required by regulation or special notice to the claimant.

"(C) In the absence of fraud or of mistake in mathematical calculation, the findings of fact and the decision of the Commissioner upon the merits of any claim presented under this subsection 21 (d) shall not be subject to review by any other administrative or accounting officer, employee, or agent of the United States.

"(5) The Commissioner shall allow the claim only to the extent that it be established to his satisfaction, and he shall find, that the claimant bore some or all of the burden of the tax himself, and did not shift it to others by selling the article or performing the services for a price which included the tax or by purchasing the commodity at a price reduced to compensate the claimant for the tax, or in any other manner.

"(6) (A) Where the refund claimed is for a processing tax (but not for a custom-processing tax) paid, it shall be prima-facie evidence that the burden of the tax was borne by the claimant to the extent (not to exceed the amount of the tax) indicated by the circumstance that the average margin per unit of the commodity processed, was lower during the tax period than it was during the period before and after the tax. If the average margin is not lower, it shall be prima-facie evidence that none of the burden of the tax was borne by the claimant but that it was shifted to others.

"(B) Such average margin for any period shall be determined by computing the average amount obtained from the sale of the articles derived from each unit of the commodity, and deducting therefrom the sum of (1) the average amount paid by the claimant for each such unit of the delivered commodity and (2) the amount of any processing tax paid with respect thereto. The amount paid for the commodity shall be either the current market price at the time of processing of the commodity, or the actual cost of the commodity processed, according to the usual accounting procedure of the claimant. The amount obtained from sale of the articles shall be either the current market price at the time of processing of the commodity, or the actual receipts from the articles sold, according to the usual accounting procedure of the claimant. If the accounting procedure of the claimant is based upon actual costs of the commodity or actual receipts from the articles, and specific lots thereof cannot be traced, then he may be considered to have processed each unit of the commodity in the order in which it was acquired, and to have sold each article in the order in which it was processed.

"(C) (1) The tax period shall mean the period with respect to which the claimant actually paid such processing tax or taxes to a collector of internal revenue; and (2) the period before and after the tax shall mean the twenty-four months (except that in the case of tobacco it shall be the twelve months) immediately preceding the effective date of the processing tax, plus the six months February to July, 1936, inclusive. Information relating to these last six months may be filed by amendment if the claimant so desires. If, during any part of such period, the claimant was not in business, or if his records for any part of such period are so inadequate as not to provide satisfactory data, the average margin of the taxpayer for such part of such period shall, when necessary for a fair comparison, be deemed to be the average margin, as determined by the Commissioner, of representative concerns engaged in a similar business and similarly circumstanced.

"(D) If the claimant bought the commodity from an affiliate, the cost may be considered by the Commissioner to be the amount paid for such commodity by the affiliate which bought from a nonaffiliated seller. If the claimant sold the article to an affiliate, the selling price may be considered by the Commissioner to be the amount received on the sale of such article by the affiliate which sold to a nonaffiliated buyer.

"(E) Notwithstanding that the average margin was or was not lower during the tax period than it was during the period before and after the tax, either the Commissioner or the claimant may show that the change or lack of change in the average margin was due to changes in factors other than the processing tax. Such factors shall include (but shall not be limited to) any clearly shown change (A) in the type or grade of article or commodity, or (B) in costs of production. Where a claimant asserts that the burden of the tax was borne by him and that the burden of any other increased cost was shifted to others, the Commissioner shall determine, from the respective effective dates of the tax and of the other increase in cost as compared with the date of the change in margin, and from the general experience of the industry, whether the tax or the increase in cost was shifted to others. Where the Commissioner determines that the change in margin was due in part to the tax and in part to the increase in other cost, he shall apportion the change in margin between them. If a claimant processed an agricultural or other product in addition to the commodity with respect to which he claims a refund, and if the Commissioner determines that the burden of the tax was shifted in whole or in part by means of the transactions relating to such product, the average margin with respect to such product shall also be considered in the manner and with the effect provided in this subdivision (6).

"(F) If the claimant modified contracts of sale, or adopted a new contract of sale, to reflect the initiation, termination or change in amount of the tax, or at any such time changed the sale price of the article (including the effect of a change in size, package, discount terms, or any other merchandising practice) by substantially the amount of the tax or change therein, or at any time billed the tax as a separate item to any vendee or indicated by any writing that the sale price included the amount of the tax, or contracted to refund any part of the price in the event of recovery of the tax or decision of its invalidity, it shall be prima facie evidence that he did not bear the burden of the tax; but the claimant may establish that such acts were caused by factors other than the processing tax, or that they do not represent his practice at other times during the tax period.

"(7) Where the refund claimed is for floor stocks, import compensating or custom-processing taxes paid and the Commissioner has disallowed such claim in whole or in part, or where the Commissioner has failed to allow or disallow any

claim (including one for processing taxes) within eighteen months after it was filed, unless such time has been extended by written consent of the claimant, or where he has failed to serve a copy of his findings of fact and conclusions of law within ninety days after conclusion of the hearing provided in subdivision (8) of this subsection (d), the claimant may bring suit in the manner, and subject to the conditions and limitations, otherwise provided by law.

"(8) (A) Within ninety days after the date of the mailing of a notice that a claim for the refund of processing taxes paid has been disallowed, in whole or in part, the claimant may file a petition with the Commissioner requesting a hearing on the merits of his claim, and a reconsideration of the Commissioner's determination and finding.

"(B) Within ninety days after the filing of such petition, the Commissioner shall set a date and designate a place for such hearing and shall notify the claimant thereof by registered mail. Such hearing shall be set for a day certain not more than one year after the date of the filing of the petition and may be continued from day to day, during a period not to exceed two years from the date of the filing of the petition and for a longer period upon the written consent of the claimant.

"(C) The hearings authorized by this subdivision (8) shall be conducted by the Commissioner, or such officials of the Treasury Department as he may designate to act as presiding officers, and shall be open to the public. The Commissioner is authorized, with the approval of the Secretary of the Treasury, to prescribe rules of procedure and evidence, conforming as nearly as may be practicable to those of the Board of Tax Appeals. The claimant shall be entitled to be represented by counsel, to have witnesses subpoenaed, and to examine and cross-examine witnesses. The presiding officer shall have authority to administer oaths, examine witnesses, rule on questions of procedure and the admissibility of evidence, and require, by subpoena in the Commissioner's name, the attendance and testimony of witnesses, and the production of all necessary returns, books, papers, records, correspondence, memoranda, and other evidence, from any place in the United States at any designated place of hearing, and the taking of a deposition by any designated individual competent to administer oaths. The Commissioner shall serve a copy of his findings of fact and conclusions of law by registered mail on the claimant after conclusion of the hearing.

"(D) The Commissioner is authorized to draw up a table of costs and fees, relating to such hearings, not to exceed with respect to any item those charged in the Supreme Court of the United States. The costs shall be assessed and collected (in the manner provided by section 19 (b) for the collection of taxes imposed under this title) against a claimant when the hearing provided by this subsection results in no modification of the determination made under subdivision (5) of this subsection (d).

"(9) (A) If the Commissioner, after the hearing prescribed in subdivision (8) of this subsection (d) disallows, in whole or in part, a claim for refund of processing taxes paid, the claimant may file a petition for review within six months after a copy of the Commissioner's findings of fact and conclusions of law have been served on him. The Commissioner shall certify and deliver to the claimant a transcript of the proceedings before him, within three months after request by the claimant and after payment of a fee, to be prescribed by the Commissioner in an amount substantially equivalent to the actual cost of preparing and certifying such transcript.

"(B) The United States Circuit Court of Appeals and the United States Court of Appeals for the District of Columbia shall have exclusive jurisdiction to review the determination of the Commissioner, except as provided in Section 239 of the Judicial Code, as amended, and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 240 of the Judicial Code, as amended.

"(C) Such findings and conclusions may be reviewed by the United States Circuit Court of Appeals for the circuit in which is located the collector's office to which was made the return of the tax for which a refund is claimed, or, if no return was made, then by the United States Court of Appeals for the District of Columbia; or any of such courts may review such determination if designated by the Commissioner and the claimant by stipulation in writing.

"(D) Such courts are authorized to adopt rules for the filing of the petition for review, the preparation of the record for review, and the conduct of proceedings in review.

"(E) Upon such review, such courts shall have power to affirm, or, if the determination is not in accordance with law, to modify or to reverse it, with or without remanding the cause for a rehearing, as justice may require.

"(F) If the determination of the Commissioner is affirmed, costs shall be awarded against the claimant. If such determination is reversed, the judgment shall provide for a refund of any costs and fees paid by the claimant pursuant to subdivisions (8) (D) and (9) (A) of this subsection (d). If such determination is modified, costs shall be awarded or refused as justice may require.

"(10) (A) The decision of the Commissioner made after the hearing provided in subdivision (8) of this subsection (d) shall become final (1) upon the expiration of the time in which to file a petition for review in an appellate court, if no such petition has been duly filed, (2) upon issuance of a mandate of affirmance by an appellate court, or (3) upon his entry of a final order made in conformity with a mandate of modification or reversal issued by an appellate court. If an appellate court remands a case to the Commissioner for a rehearing, his subsequent decision shall become final in the same manner as though he had rendered no prior decision.

"(B) As used in this subsection (10), the term 'appellate court' means the Supreme Court of the United States, a United States Circuit Court of Appeals, or the United States Court of Appeals for the District of Columbia.

"(11) No interest shall be allowed in connection with the recovery, recoupment, set-off, refund, or credit of, or counterclaim for, or customs protest against, any amount paid as tax, penalty, or interest under this title.

"(12) The Commissioner may appoint such officers, attorneys, economists, and other experts, without regard to the Classification Act of 1923, and Acts amendatory thereof, and without regard to the civil-service laws or regulations, as are necessary to execute the functions vested in the Commissioner by this subsection (d). No salary in excess of \$8,500 per annum shall be paid to any such appointee.

"(13) (A) There is hereby authorized to be appropriated, out of any money in the Treasury not otherwise appropriated, the sum of \$— to be available to the Commissioner for administrative expenses and refunds under this title. Such sum shall remain available until expended.

"(B) The administrative expenses provided for under this subdivision shall include, among others, expenditures for personal services and rent in the District of Columbia and elsewhere, for law books, books of reference, press releases, trade journals, periodicals, and newspapers, for contracting reporting services, printing and paper in addition to allotment under the existing law, travel expenses, for mileage and per diem in lieu of subsistence of witnesses, payment of which may be made in advance upon certification of such officer as the Commissioner may designate and such certification shall be conclusive. In addition to the foregoing, the administrative expenses provided for under this subdivision shall include such miscellaneous expenses as may be authorized or approved by the Commissioner for carrying out the provisions of this title, including witness fee and mileage for experts, notarial fees or like services, and stenographic work for taking depositions.

"(14) Subsections (a), (b), (c), and (g) of this section 21 are hereby repealed.

"(15) If the application of any provision of this subsection (d) to any person or circumstance is held invalid, the remainder of the subsection, and the application of such provision to other persons and circumstances, shall not be affected thereby."

Sec. 604. The provisions of sections 8 (2), 8 (6), 8 (7), 8 (8), 8 (9), 9 (a), 9 (b), 9 (d) (1), 9 (d) (2), 9 (d) (3), 9 (d) (7), 9 (d) (8), 9 (e), 9 (f), 9 (g), 12 (b), 15 (b), 15 (b-1), 15 (b-2), 15 (b-3), 15 (d), 15 (e), 16 (a), 16 (b), 16 (c), 16 (d), 16 (e) (2), 16 (e) (4), 16 (e) (5), 16 (f), 17 (b), 18, and 19 of the Agricultural Adjustment Act, as amended, are repealed, as of January 5, 1936. No tax, civil penalty, or interest which accrued under any provision of law repealed by this title, and which is uncollected on the date of the enactment of this title, shall be collected; and all liens for taxes, civil penalties, or interest arising out of taxes under such provisions of law are canceled and released.

Sec. 605. (a) Section 2 (1) of the Agricultural Adjustment Act, as amended, is amended by striking out the words "balance between the production and consumption of agricultural commodities, and such marketing conditions therefor, as will reestablish", and by inserting in lieu thereof the following: "conditions with respect to the handling of agricultural commodities or the products thereof in the current of interstate or foreign commerce (including the regulation of those conditions which burden, obstruct, or affect interstate or foreign commerce in

such commodities or products thereof) as will promote the general welfare by reestablishing and maintaining."

(b) Section 9 (e) of the Agricultural Adjustment Act, as amended, is amended by striking out the last sentence of said section.

(c) Section 10 (c) of the Agricultural Adjustment Act, as amended, is amended by striking out the comma following the word "title" and inserting in lieu thereof a period and by striking out the words "including regulations establishing conversion factors for any commodity and article processed therefrom to determine the amount of tax imposed or refunds to be made with respect thereto."

(d) Section 12 (e) of the Agricultural Adjustment Act, as amended, is amended by striking out the words "and refunds made" in the second sentence of said section.

(e) Section 15 (f) of the Agricultural Adjustment Act, as amended, is amended to read as follows:

"(f) The President, in his discretion, is authorized by proclamation to decree that all or part of the taxes heretofore or hereafter collected in the Territory of Hawaii, the possession of Puerto Rico, and the Virgin Islands with respect to any processing, manufacture, or sale of sugar beets, sugarcane, or sugar in those areas or upon the processing, manufacture, or sale in the continental United States of sugar beets, sugarcane, or sugar produced in or coming from those areas, shall not be covered into the general fund of the Treasury of the United States but shall be held as a separate fund, in the name of the respective area to which related, to be used and expended in whole or in part for the benefit of agriculture, including research and scientific experiments, investigations, and surveys with respect to diversification of agriculture and land use in those areas, or for the purposes of the Soil Conservation and Domestic Allotment Act or the Sugar Act of 1936, as the Secretary of Agriculture, with the approval of the President, shall direct. The funds authorized to be held as a separate fund as herein provided are hereby appropriated to be available to the Secretary of Agriculture for the purposes for which said funds are established, together with administrative expenses in connection therewith, and said sum shall remain available for such purposes until expended."

SEC. 606. The provisions of section 13 of the Agricultural Adjustment Act, as amended, are hereby continued in force but only for the purpose of carrying out the provisions of sections 1, 2 (as amended by section 605 (a) of this title), 3 to 5, inclusive, 7, 8 (1), 8 (3), 8 (4), 8 (5), 8a, 8b, 8c, 8d, 8e, 8f, 9 (c) (as amended by section 605 (b) of this title), 9 (d) (6), 10 (a), 10 (b), 10 (c) (as amended by section 605 (c) of this title), 10 (e), 10 (f), 10 (g), 10 (h), 10 (i), 11, 12 (a), 12 (c) (as amended by section 605 (d) of this title), 14, 15 (f) (as amended by section 605 (e) of this title), 20, 21 (c), and 22 of said act, as amended, which said sections are hereby reenacted. *Provided, however,* That no repeal, reenactment, or amendment made by this title shall be construed to import illegality to any act, determination, proclamation, certificate, regulation, ruling, order, agreement, or license of the Secretary or of the President done or made under the provisions of the Agricultural Adjustment Act, as amended, which are reenacted by this section prior to the date of the enactment of this title, all of which are hereby legalized, ratified, and confirmed.

Mr. WALLACE. I think you will get the sense a little easier from the explanation which I will now read.

Senator KING. All right.

Mr. WALLACE. It sets forth the procedure as to the making of claims for the refund of processing taxes.

"The claim under the suggested amendment would be filed just as any ordinary claim for a refund. In view of the large number of taxpayers who might file claims, and so as to give the Bureau of Internal Revenue an adequate period of time within which to consider the claims, a longer period of limitations is given than under the present laws within which the Commissioner may consider and reject or allow the claim. If the claim is allowed no hearing would be held. If the claim is disallowed, the claimant may petition for a hearing within 90 days after the disallowance. The taxpayer may subpoena witnesses and be represented by counsel. The Commissioner is empowered to name a person to preside over such hearings who

may place witnesses under oath; the witness may be examined and cross-examined. If the claim is allowed as a result of this hearing, nothing further is required to be done. If the claim is disallowed, the claimant may petition for a review of any error of law by a United States Circuit Court of Appeals. If the findings of the Commissioner are in accordance with law, they are not reviewable."

Senator WALSH. Are the persons whom the Commissioner can name to hear the evidence and determine the facts, officials of the Internal Revenue Department or outsiders?

Mr. WALLACE. I suppose they will be employees of the Bureau of Internal Revenue.

The CHAIRMAN. The Secretary was not reading from the amendment.

Senator HASTINGS. Does your amendment provide that the representative of the Internal Revenue shall have the definite and final conclusion?

Secretary WALLACE. Not with respect to questions of law. Senator HASTINGS. But with respect to questions of fact? All of these things are questions of fact. Whether he passed it on or did not pass it on is purely a question of fact. Does your amendment propose that the commissioner shall decide?

Secretary WALLACE. The commissioner would be final with respect to questions of fact.

Senator HASTINGS. So if he wanted to, he could throw them all out and nobody would have any redress.

Secretary WALLACE. I think so far as the questions of fact are concerned. There are certain matters governing questions of fact which are set forth later, which I think should be heard before there is further discussion on that particular point.

"If the court finds that the commissioner erred as a matter of law, the case may be reserved or remanded for further hearing by the commissioner. The power of the courts to reverse such findings would be in all respects similar to and no greater than the power to reverse a decision of the United States Board of Tax Appeals (See *Helvering v. Rankin*, 295 U. S. 123). If, however, the Supreme Court should decide that a claimant is constitutionally entitled to the independent judgment of the court on the facts (see *St. Joseph Stockyards Co. v. United States*, No. 497, decided Apr. 27, 1936), the courts would have power to examine the evidence before the commissioner as a question of law. Except as to the statutory period of limitations, the procedure outlined is that which was contemplated in section 21 (d) as it now reads. Of course if deemed desirable, a quasi-judicial administrative board could be substituted for the commissioner."

In that, the Treasury has in mind a different procedure. Senator KING. I see no impropriety in making some official of the Treasury the final arbiter on the question of fact. Of course, if the facts are so obscure or so indefinite as to become a question of law, and we have that in our chancery proceedings, then as a matter of law, the higher court can review it. It seems to me you are following a very sound judicial procedure there.

Secretary WALLACE. A little later we will discuss the method of measurement which would enter into the determination of the question of fact. But first, there is a question of procedure in the case of floor stock taxes, which are slightly different than the procedure with regard to processing taxes.

"The procedure just outlined is suggested for application only to claims for refunds of processing taxes, which constituted 88 percent of all taxes paid under the Agricultural Adjustment Act. There were only 73,000 payers of processing taxes, of whom but 1,400 paid about 95 percent of the processing taxes collected.

"The procedure in the case of floor stock taxes paid:

"Since there are about 1,193,000 floor stocks taxpayers, who paid only about 10 percent of the total amount of taxes involved, and since the questions presented are far simpler, the hearings provided for in the case of processing taxes have not been recommended for this class of claimants but the taxpayer, upon rejection of his claim, is allowed to proceed in the same manner as claimants for refunds generally under the revenue laws."

Senator KING. Pardon me for interrupting. Out of that 1,400 were there processors who were millers and who had to deal with cereals and so on?

Secretary WALLACE. Oh, yes. This is quite different from those involved with the packers. This would deal with cotton spinners, cigarette manufacturers, wheat millers, and so on.

Senator COUZENS. May I ask at this point: There have been suggestions made before the committee that to simplify this refunding of floor tax, it might be desirable to refund the taxes that they paid at the beginning of the act rather than to attempt to fix inventory on January 6, 1936. Have you any views about that?

Mr. WALLACE. We have some definite views on that, but it is a highly technical problem, exceedingly technical.

Senator COUZENS. I am not asking you to go into it.

Mr. WALLACE. I have not been into the precise details of that particular question for 6 weeks, and if I discussed it at this time, I might create confusion, and I am sure that what you are after is light and justice with respect to this particular point, and I would prefer not to answer it. It might be that one of our men here would be sufficiently posted on it now who might be able to answer your question now if you care to ask it of him.

Senator COUZENS. I won't ask it now, but I would like at some time to go into that question, because it seems to me it would simplify the procedure if you took it as of the payment of the tax rather than as of inventory on January 6, 1936.

The CHAIRMAN. And if you could give us any figures how much the loss would be in revenue.

Mr. WALLACE. Shall I have one of our men get in touch with Senator COUZENS and then write you a letter with regard to this particular point?

Senator COUZENS. I prefer that the whole committee get it whenever you are ready. I am not pushing it now; I just want the information at some time.

The CHAIRMAN. Just furnish it to us, and also about the revenue involved in the two plans.

Senator WALSH. The point was made here that it would be simpler to take it as of the time that they paid the tax.

Senator CLARK. You note here that 1,400 out of the 73,000 processing taxpayers paid 95 percent of the taxes collected, and then this provision—of course the other 71,000 would be subjected to the same drastic procedure as the 1,400, would they not?

Mr. WALLACE. They would be subjected to the same procedure.

Senator CLARK. Do you not think it is a very drastic procedure to have an officer of the Agricultural Department passing upon the matter finally, as a matter of fact, with no review by any court whatsoever?

Mr. WALLACE. It does not happen to be an officer of the Agricultural Department.

Senator CLARK. An officer of any department.

Mr. WALLACE. It happens to be the Commissioner of Internal Revenue.

Senator CLARK. An officer of any department, passing finally as a matter of fact, and not subject to judicial review.

Mr. WALLACE. The method of ascertaining the facts being set forth by the Congress.

Senator CLARK. A mere ministerial officer acting as a final arbiter, not subject to any judicial procedure whatsoever. Don't you think that is drastic procedure?

Mr. WALLACE. I would think, Senator, that it might be well if you would delay asking the question until I read a little further here.

The CHAIRMAN. All right, Mr. Secretary.

Mr. WALLACE. As to the justification for the rules suggested:

"In proposing specific rules to guide the Commissioner in determining whether or not the processor has actually paid the tax, the proposed amendment places main reliance on a comparison of processors' margins before, during, and after the tax was in effect."

That is a very significant sentence there. That is the heart of the procedure here suggested, that the main reliance be placed on a comparison of processors' margins before, during, and after the tax was in effect.

"It is a well-known fact that, in the case of most of the commodities affected by the processing taxes, the amount of the tax was quite large compared to the normal margins retained by processors between the price at which they buy the raw material and the price at which they sell the finished products. Accordingly, if the processor shifted the burden of the tax, either by increasing his selling price down, or by reducing his buying price below, what it otherwise would have been, this would be evidenced by an increase in his gross operating margin retained during the tax period. On the other hand, if he actually absorbed the tax himself, that would be shown by the fact that his gross margin during the period the tax was in effect would be no larger than when there was no tax. The tendency to increase margins during the time that the tax was in effect is illustrated in figures 1, 2, and 3, appendix II, prepared by the Bureau of Agricultural Economics from data obtained from trade sources."

Because of the fact that the other Senators had not these appendices, I am going to ask Mr. Savoy to supply them with them.

The CHAIRMAN. I think we had better put them in the record now.

Secretary WALLACE. You will notice in the upper figure [referring to chart] the buying price is indicated in the lower line with respect to wheat, and the selling price of the wheat products is indicated in the upper line. The upper chart seems somewhat confusing, but the essence of it is indicated in the lower chart, which is the subtraction of the lower line from the upper line, and thus gives precisely the amount of the margin, definitely.

Taking the lower chart, therefore, which begins in January of 1932, you will see that the amount of the margin expressed in cents per bushel between what was paid to the farmer for wheat and what was obtained from the product of that bushel, was about 37 cents, roughly, and went along just about that point, 37 cents to, say, 43 cents, just roughly estimating from the chart, up until April of 1933, and then a number of things began to get in the wind. And there was a little bit of an increase.

Senator CAPPER. Where is that on the chart?

Mr. WALLACE. Mr. Savoy is pointing to it with his pencil.

Then in July 1933 when the processing tax went into effect, there was that sudden increase up to a little above 75 cents.

You remember in July, there were a number of uncertainties. We had in the Department of Agriculture, and there had been suspended since October 1933, the requirements of reporting of speculative transactions, and those had not been reinstated, and there was a terrific wheat speculation as the result of a number of things about which nobody in the Government knew anything, definitely. Wheat prices were skyrocketing and nobody knew just what the price of flour ought to be. That thing smashed, as I remember it, on July 17.

I think possibly that situation had something to do with that unusual peak in margins there. Not attributing anything improper on the part of the millers in any sense. Nobody knew what the situation was, I think. It was a vast speculative boom which collapsed in the middle of July 1933. We reinstated our reporting requirements at that time.

Then of course, the N. R. A. came in a little later. It did not have so much effect here as it did with the cotton spinners, however, which caused certain uncertainties as to just what that margin should be. The thing began to settle down, however, a little later. I do not know what the average margin there is as compared with the previous margin.

Do you happen to know, Mr. Savoy, what the average margin for that period was? You can read it roughly off the chart, you see. The chart itself gives what I am after. That lower line subtracts the processing tax from the total margin and gives what the margin would have been if there had been no processing tax; the real extent to which the latter part of the lower line continues the early part of the line previous to July 1933.

This next chart shows the picture in the case of hogs. It is the same kind of a picture. You have the margin from January 1933 until November 1933 and the processing tax was put on gradually; first of 50 cents a hundred, and then stepped up a little later to \$1, and finally to \$2.25. So beginning with November 1933 the lower line continues what the margin would have been after the processing tax, whatever it was, was subtracted.

You note in a rough way that it continues the preprocessing tax margin, and that after the tax was removed, that the situation of the lines goes back to where it was in the preprocessing tax period.

Senator BLACK. Do you mean that the margins between the price paid for the hogs and the price at which they were sold after processing remained practically the same both before the processing tax was put on and after the processing tax was put on?

Mr. WALLACE. Yes, sir; provided you take and subtract the processing tax during the period of the processing tax.

Senator BLACK. But if you do not subtract the processing tax, the margin was a great deal more.

Mr. WALLACE. It was greater by the amount of the processing tax.

Senator BLACK. If the processing tax were permitted to be retained on the hogs as far as the general business is concerned, the profits would be increased and the margin would be increased by the exact amount of the processing tax, according to that chart.

Mr. WALLACE. You cannot tell anything exactly from a chart.

Senator BLACK. I say, approximately, from the chart.

Mr. WALLACE. Yes. That is what you would judge.

Senator BLACK. In general, not taking the individual cases of packers, but the profits as a whole of the industry.

Mr. WALLACE. In toto, yes.

Senator GEORGE. The chart merely indicates, I judge from your statement here—you considered only the price paid for the raw material and the price received, and no consideration has been given for any other change in the variable factors involving the costs of production and manufacture.

Mr. WALLACE. You are speaking of labor, particularly?

Senator GEORGE. Yes.

Mr. WALLACE. We might say that we have to some extent as a corrective of that situation, the margin as it exists after the tax was removed.

Senator GEORGE. But I say, your charts are made on that basis?

Mr. WALLACE. They are made on that basis; yes, sir.

Senator GEORGE. Of the purchase price, the cost of the raw product and the selling price?

Mr. WALLACE. That is correct, Mr. Savoy, that the charts are made on that basis of the absolute margin between what is paid for the product and what is obtained for the product, so that if there has been marked increase of labor, that does not appear?

Mr. SAVOY. That is correct.

Mr. WALLACE. This [indicating] is the cotton situation in a similar manner. Neither, may I say, Senator, has been taken into account a saving that might come, we will say, from improvements in technique during the period. You will notice, for instance, in the cotton textile business, that the margin there—you have, starting back in the year 1925, you will find rather an unusual thing. The margin between the price of the product and the selling price of the finished goods is steadily going down all the way there to 1933. It is rather an unusual situation of the impact of technology in the particular business.

Senator BAILEY. Mr. Secretary, the chart shows the margin, but does it relate itself to volume of sales?

Mr. WALLACE. No; not at all. Those things are not taken into account.

Senator BAILEY. But if the loss was due to decreased volume, it would still be a loss? Does it tell us if there was a considerable reduction in the volume of sales of grey goods in the periods shown on the charts?

Mr. WALLACE. Senator, the only light which I could throw on that, which I think would be a dimmer light than you yourself could throw,

is the light which I obtained from listening to the presentation before the cabinet committee by the textile industry a year ago, and if I remember the figures, there was a considerable reduction in the volume of sales of grey goods during that period.

Senator BAILEY. The spindles in place in this country were down about 8,000,000 from the peak.

Mr. WALLACE. I have here, Senator, if you would be interested, a chart which gives in percentage terms the consumption of cotton goods in the United States beginning in 1923. If you will phrase your question with the time element in it, I might be able to give an answer.

Senator BAILEY. The time indicated by the chart.

Mr. WALLACE. I do not have it quite that far back. Taking the years 1923 to 1925 as 100; in the year 1928 it would seem that the consumption was 20 percent above that normal; in 1929, the consumption was apparently about 7 percent above that base; in 1930, it was about 14 percent above that base; in 1931, it was about 13 percent under that base; in 1932, about 12 percent under that base; in 1933, it apparently was about 19 percent under, although in the latter part of 1933 there was a terrific upturn until it looks like in the month of August or the late summer it reached about the 1923-25 base.

Senator BAILEY. That terrific upturn was by way of anticipation of the existence of the processing tax. They were making goods ahead of time.

Mr. WALLACE. That, or in anticipation of N. R. A. wages, or both. In 1934—this is rather interesting—it was somewhat above the 1923-25 base.

Senator BLACK. How much above?

Mr. WALLACE. It looks like it is about 8 or 9 percent above. In 1935 it is below again.

Senator BLACK. About how much?

Mr. WALLACE. About 11 percent.

Senator BAILEY. That is the consumption of cotton goods?

Mr. WALLACE. That is the consumption of cotton goods.

Senator BAILEY. Can you compare that now with the consumption of raw cotton?

Mr. WALLACE. I think that could be obtained. There would be some time lag, but the answer would be roughly the same. You mean raw cotton that does not enter into export?

Senator BAILEY. Yes. Our domestic raw cotton.

Mr. WALLACE. I do not think the answer would be greatly different, but there would be a time factor.

Senator HASTINGS. Mr. Secretary, if the processor did only half as much business as he did in former years, after the tax was put on, and the margin of profit was the same, he might very well be making very much less for his concern, might he not?

Mr. WALLACE. I think that would be an axiom, if he did only half as much business and had a small volume, he would be making less than half as much.

Senator HASTINGS. Then if your rules of determining the facts are based solely upon the difference in the margin, is that a correct rule in order to determine whether or not the processor is entitled to a return of his tax?

Mr. WALLACE. I do not think the Government would be responsible for the volume of the business done.

Senator BAILEY. The Government would not be responsible for the volume, but the increased taxes and the prices reduced the volume, and I think that should be a factor that should be taken into account.

Mr. WALLACE. I think you should take it into account.

Senator HASTINGS. Is your amendment drawn so that it can be taken into account?

Mr. WALLACE. I do not think the amendments are drawn to take that particular point into account.

Senator KING. In determining the marginal differences which you have indicated on these charts, have you taken into account the factor, for instance, of imports, increased exports, or the change in the prices of foreign goods?

Mr. WALLACE. I do not see where that would enter into it. That has not been taken into account, Senator.

Senator BAILEY. But bearing in mind all the time that the price of cotton—the tax could not be passed back to the farmer, because of the Bankhead Act lending policy of the Government.

Mr. WALLACE. The nature of supply and demand in cotton is such that there is very little evidence that it would be passed back to the farmer in any case.

Senator BAILEY. You bought 5,000,000 bales of cotton. That prevented cotton from going down, and that is the only thing that did, as far as I know. I think the processing tax would have fallen on the farmer but for the lending policy of the Government.

Mr. WALLACE. The economists seem to think that in the case of wheat and cotton the nature of supply and demand is such that very little of the tax would have been passed back to the public in the case of those two products, but in the case of hogs there is a little different situation.

Senator BAILEY. You did not lend money on hogs?

Mr. WALLACE. It is a different type of demand. I do not fully agree with the economists, you understand, Senator. I dispute with them on the hog situation. I have felt right along that the thing was passed much more largely on to the consumer than most of the economists think.

Senator BAILEY. You will agree to this effect, that as long as the Government was lending 12 cents a pound on cotton, that all the farmer had to do was to put it in the warehouse and he could be assured of 12 cents, and that the Government would hold the bag. That was pegging the price at 12 cents. That was the effect of that loan. Then we reduced it to 10.

Mr. WALLACE. We started out at 10, increased to 12, then reduced again to 10.

Senator BAILEY. That had the effect of pegging the price?

Mr. WALLACE. Yes.

Senator GEORGE. Mr. Secretary, as a matter of fact then, whatever our theories may be about it, as a matter of fact, in the case of hogs, in the early days of the processing tax, it was frequently passed back to the producer. He frequently sold his hogs on the market less the processing tax.

Mr. WALLACE. I do not like to use the word "frequently", because that would suggest that was passed back in the case of one farmer and not in the case of his neighbor. In hogs, there is such a thing as a

national market and the price on a given day tends to be roughly the same less the customer price differentials in all the markets.

Senator GEORGE. While there is a national market, there is quite a difference between prices for hogs in different sections. For instance, a peanut-fed hog suffered all of these years.

Mr. WALLACE. That is one of the customer price differentials that the packers try to enforce.

Senator GEORGE. And nobody can quite figure it except the packer. As a matter of fact I happened to be raising hogs when the processing tax went in, and I sold some hogs from which the processing tax was bodily taken on the basis of any market.

Mr. WALLACE. That was an illegal thing. We had a number of complaints of that sort.

Senator GEORGE. That did not continue very long, as a matter of fact.

Mr. WALLACE. No.

Senator GEORGE. Generally, at least in my section. In other words, after the processing tax had been in effect some time, we began to get the market or substantially the market, and I presume they were not passing it back to the producer.

Mr. WALLACE. I do not think any of the large packers undertook to do a thing of that sort.

Senator GEORGE. I did not say that, of course. They were the intermediate buyers.

Mr. WALLACE. I think some of them may perhaps have tried to do a thing like that.

Senator GEORGE. And the intermediate buyers, they perhaps themselves did not know how they could handle their own problems, so they simply took the tax out of the price paid.

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

Mr. WALLACE. This is rather a detailed discussion here. Shall I take up your time with this? I do not know whether there are any points in the detailed discussion that I have not brought up. I have discussed figure 1, figure 2, and figure 3.

Senator COUZENS. Let us eliminate those that you have already discussed.

The CHAIRMAN. Only discuss those things that you have not already taken up.

Senator BARKLEY. Those figures will go into the record.

Mr. WALLACE. We might as well put those in the record, I suppose.

The CHAIRMAN. Yes; the whole thing will be in the record.

Senator BARKLEY. These charts will be in the record too, will they not?

The CHAIRMAN. Yes. All right, you may proceed.

(The charts (appendix II) referred to will appear in the revised hearings.)

Mr. WALLACE. These exhibits are introduced merely to illustrate that, in the case of three of the major commodities involved, facts as to changes in gross margins are obtainable and do provide a positive basis for manufacturers to show whether or not they did in fact absorb the tax. These charts, of course, are based merely on the average figures obtained from the available market quotations.

In other words, these charts illustrate in a general economic sense the general situation. While they illustrate the principle they are not the precise method which would be used in practice. They

illustrate, to my mind, the broad, general justice of the method which would be used in practice. I well realize that in many of these broad, governmental activities, especially where taxes are involved, there are, of necessity, literally hundreds of specific injustices. The question is to discover the rule which will make for the maximum of justice and the minimum of injustice. I do not know of any particular rule that will completely eliminate injustice.

As I say, the charts are based on the general situation. In claiming refunds, each manufacturer would be expected to use his own records, indicating exactly what the situation was in terms of his own operations. The suggested provisions indicate clearly the data which manufacturers might need to submit in making such a showing.

In addition to these general margin provisions for creating a prima-facie presumption whether or to what extent the taxpayer bore the burden of the tax, a number of supplementary provisions are suggested to cover special situations. One of these special situations is in cotton textiles, where other factors, such as N. R. A. codes, were increasing costs as well as the processing taxes. In such cases either the claimant or the Commissioner of Internal Revenue may introduce evidence indicating the extent to which these special circumstances explain the changes shown in the margin, and the Commissioner of Internal Revenue is directed to give such evidence due weight in determining whether the processor bore the burden of the tax and in arriving at the amount of the refund due the claimant.

I do not know whether that covers the point in which you are interested, Senator George, or not.

Senator GEORGE. It does, in a sense; yes, sir. I merely wanted to know, though, what factors were taken into consideration in the preparation of the charts. That is what I was driving at.

Mr. WALLACE. Yes.

Senator GEORGE. Not whether anything else should have been taken into consideration necessarily, but what actually was used as a basis.

Mr. WALLACE. Provisions are also made for the Commissioner to take into consideration other evidence indicating who bore the burden of the tax, such as, for example, the practice of a concern in including the cost of the tax as a specific item in billing its customers.

In the case of certain processors the tax was included in the bill to the consumer. Senator George has given an illustration where the processor attempted to bill the producer for it. There are other processors who made it a very regular procedure to bill the consumer for the tax.

Senator COUZENS. That is, the billing was separate on the invoice?

Mr. WALLACE. Yes.

Senator COUZENS. So that would be prima-facie evidence of passing it on.

Mr. WALLACE. Yes. It might be noted that the language proposed as a substitute for the existing language of section 21 (d) is consistent with the language which the House has already adopted for the "wind-fall" taxes, in that the conditions under which a processor could show that the return to him of impounded taxes was equitable, because he had in fact borne the burden of the tax himself, are the same as those which would constitute prima-facie evidence that he was entitled to the refund of the taxes which he had previously paid. The substitu-

tion of the proposed language for section 21 (d), together with the approval on your part of the "windfall" taxes as passed by the House, would, therefore, prevent the unjust enrichment which might otherwise result from the invalidation of the taxes under the Agricultural Adjustment Act, by providing for repayment in full of those taxes the burden of which was borne by the taxpayer, but not those paid by the consumer or the producer, and also by providing for the recapture of a major portion of the "windfall" income in those cases where the processor had not paid any tax, although he collected its equivalent.

Senator KING. Mr. Secretary, pardon the interruption. If you care to express an opinion I would be glad to have you do so, and if not, then do not hesitate to indicate your lack of desire. Having read, as you doubtless have, the bill as it passed the House dealing with the so-called windfall tax, do you see any imperfection or defects in it which need to be strengthened materially?

Mr. WALLACE. When you speak of imperfections or defects you get into a field where I, as many others, rely on the judgment of men who spend many hours a day looking into the minutia of such things.

Senator KING. Of course, you now refer to the Internal Revenue, not to the Senate or the House?

Mr. WALLACE. I am referring to you gentlemen and your advisers.

Senator BARKLEY. I want no invidious references made there by the intimation that these Members of Congress do not spend hours on matters of this kind.

Mr. WALLACE. There is no use fooling ourselves by pretending to do things that are superhuman.

Senator KING. In your view is it a reasonable measure or does it work injustices?

Mr. WALLACE. It seems to me that, for my own part, the imperfection, I would say, is the amount of recapture. That is only 80 percent. I would think it ought to be a higher percentage, but it may be the most practical point at which to put it after taking everything into account.

Senator CONNALLY. Mr. Secretary, the reason for it is that if the amount were 100 percent there would be a serious question of confiscation.

Mr. WALLACE. I have never suggested 100 percent, Senator.

Senator CONNALLY. You run into very able-bodied competition.

Mr. WALLACE. It may be that those of you who have had prolonged experience in weighing constitutional matters and who are in sympathy with the object of the windfall tax nevertheless feel, after taking everything into account, that is the best way in which to serve justice. I would not quarrel with it. I merely express regret that it could not be 90 percent, because some people think that the gentlemen are entitled to receive out of the Federal Treasury sums of money that will be, in many cases, three, four, and five times as much as their annual profits in prosperous years. There is something in me that rises up in wrath at that kind of situation.

Senator KING. I think that view would be entertained by some of us.

The CHAIRMAN. All right, Mr. Secretary.

Mr. WALLACE. That leaves that particular discussion on section 21 (d). The next discussion has to do with the extension of principle

of refund provisions of title IV of H. R. 12395. This has to do with the sugar situation.

The CHAIRMAN. As I understand the sugar proposition, the law that we passed runs out in 1937.

Mr. WALLACE. Yes.

The CHAIRMAN. It is necessary, in order to carry it out, that the processing tax on sugar to the amount of the differential between the Cuban rates and our taxes under the Cuban Treaty should be continued.

Mr. WALLACE. Yes; that is mentioned, incidentally, here, although it is more in detail that particular matter is mentioned in a separate letter to you.

The CHAIRMAN. Yes.

Mr. WALLACE. In title IV of H. R. 12395, the Committee on Ways and Means undoubtedly sought to cure the inequities which have resulted from the decision of the Supreme Court invalidating the tax and related provisions of the Agricultural Adjustment Act. Two situations appear to have escaped the attention of the committee.

One class of cases requiring individual attention, due primarily to the fact that the tax on all sugars marketed prior to December 1, 1935, was paid and to the further fact that the Agricultural Adjustment Act, provided for export refunds in the case of articles manufactured wholly or partly from a taxed commodity, is that of exporters who held on January 6, 1936, articles manufactured wholly or partly from tax-paid sugar, and who have exported and are exporting such articles at a price diminished by an amount representing the processing tax on sugar.

There is a particular situation in sugar, which demands particular handling to avoid doing injustice to particular individuals.

Senator GEORGE. Mr. Secretary, in that connection, I think some of the exporters of textiles and other things who appeared before the committee said they were not being fairly dealt with in that bill.

Mr. WALLACE. Well, it is the kind of situation that could exist there.

Senator GEORGE. The same as sugar?

Mr. WALLACE. Yes. Have you studied that situation, Mr. Savoy?

Mr. SAVOY. That is taken care of in the second situation of which you spoke.

The CHAIRMAN. When we get down to the discussion on that particular subject we can have the services of Mr. Savoy up here with us, can we not?

Mr. WALLACE. Certainly, sir. Under H. R. 12395 holders of such stocks are not entitled to a floor stocks adjustment, nor are they entitled to an export refund. It would seem equitable and in line with the other remedial provisions which have been proposed, to allow a refund, where the tax was paid, to exporters of articles manufactured wholly or partly from sugar, to the extent to which the price was reduced by an amount representing tax. So that it will be possible to have all claims for refunds on file prior to January 1, 1937, it would seem reasonable to allow this refund only as to exportations made prior to September 1, 1936. This Department, therefore, recommends amendment no. 1 contained in appendix I attached.

During the 6 months preceding January 6, 1936, a very small amount of the taxes due was collected.

Senator KING. You mean on sugar?

Mr. WALLACE. No; this is getting into another field now.

Senator KING. All right.

Mr. WALLACE. At the same time goods were being exported or delivered to charitable organizations and cotton was being manufactured into large cotton bags. If the provisions of the Agricultural Adjustment Act had been upheld, the persons doing these acts would have been entitled to specific refunds. If the tax was not paid by the processor, it is expected that a substantial portion thereof will be collected under title III of H. R. 12395, by means of the so-called "windfall" tax. If the tax was paid, the bill provides for the refund thereof in such cases. To do equity, this Department recommends that no refund in the class of cases mentioned be disallowed on the grounds that the tax was not paid.

This principle is recognized in section 602 (e) of title IV of H. R. 12395, relating to floor stocks on hand on January 6, 1936, and there would seem to be no substantial basis for any different treatment being accorded to the class of cases to which I have referred.

However, it would seem reasonable to require, in case this concession is made, that the person otherwise entitled to the refund establish that he has not received and has no contract to receive any adjustment from the processor or other vendor. This Department, therefore, recommends amendment numbered (2), contained in appendix I, attached.

Substantial revenue will be required in addition to that derived from the "windfall" net income tax. We are now getting into a discussion of possible processing taxes in the new legislation. Farmers have an interest which is as great as that of any other group in provisions for adequate Federal revenues. This interest prompts a suggestion of excise taxes on certain agricultural commodities as a means of providing such revenues.

EXCISE TAXES ON THE PROCESSING OF VARIOUS COMMODITIES

With respect to processing taxes, in addition to a processing tax on sugar beets and sugarcane (covered by separate letter), you are advised that upon the invitation of the Committee on Ways and Means of the House of Representatives, this Department, following the recommendation of the President in his message to the Congress of March 3, 1936, suggested to that committee that a possible source of revenue would be found in the imposition of a processing tax on various named commodities greater in number than those contained in the Agricultural Adjustment Act or imposed thereunder at rates far lower than those in effect under that act. Since then, and after consultation with other executive departments, this Department has revised the list of commodities and has made minor alterations in some of the rates. The commodities, the rates of tax suggested as a source of revenue, and the estimated amount of tax to be derived therefrom are set forth in appendix III.

Senator COUZENS. I would like to have appendix III read at this time.

The CHAIRMAN. Will you read Appendix III?
(Appendix III, referred to, is as follows:)

APPENDIX III

Estimated revenues from proposed schedule of tax rates, 1936-37

| Commodity | Units | Estimated net units fiscal year 1936-37 (millions) | Previous tax rate (cents) | Proposed schedule | |
|--|---------------|--|---------------------------|-------------------|-----------------------------------|
| | | | | Tax rate (cents) | Estimated revenue (1,000 dollars) |
| Basic commodities previously taxed: | | | | | |
| Wheat | Bushel | 443.00 | 30.00 M | 8.00 M | 35,440.0 |
| Rye (extract spirits) | Bushel | 7.50 | 30.00 M | 6.00 M | 450.0 |
| Corn (extract spirits) | Bushel | 137.33 | 5.00 M | 6.00 M | 7,638.9 |
| Hops | Hundredweight | 90.60 | 225.00 M | 82.10 M | 27,180.0 |
| Cotton | Pound | 2,028.97 | 4.20 M | 1.50 M | 40,433.0 |
| Rice | Pound | 1,020.00 | 1.00 M | 25 M | 4,097.0 |
| Peanuts | Pound | 425.70 | 1.60 M | 50 M | 2,126.0 |
| Slugs: | | | | | |
| Continental | Pound | 3,128.25 | .50 M | .50 M | 15,791.0 |
| Domestic insular | Pound | 5,721.67 | .50 M | .50 M | 28,608.0 |
| Foreign | Pound | 3,922.23 | .50 M | .50 M | 19,611.0 |
| Syrup ¹ | Pound | 26.00 | .50 M | .50 M | 630.0 |
| Total sugar | | | | | |
| 64,540.0 | | | | | |
| Tobacco: | | | | | |
| Cigars: | Number | 148.00 | \$12.70 M | 6.00 M | 8.8 |
| Small | Number | 4,800.00 | \$90.80 M | 40.00 M | 1,920.0 |
| Large | Number | 148.775.00 | \$12.20 M | 6.00 M | 8,595.0 |
| Cigarettes: | Number | 2.50 | \$15.70 M | 9.00 M | 6.3 |
| Large | Number | 296.50 | \$3.00 M | 1.00 M | 2,965.0 |
| Manufactured tobacco | Pound | 35.80 | \$3.00 M | 1.00 M | 358.0 |
| Snuff | Pound | | | | |
| Total tobacco | | | | | |
| 14,216.0 | | | | | |
| Basic commodities not previously taxed: | | | | | |
| Barley (extract spirits) | Bushel | 28.23 | | 6.0 | 4,099.0 |
| Oats | Bushel | 28.00 | | 4.5 | 1,710.0 |
| Cattle and calves | Hundredweight | 108.20 | | 5.0 | 5,410.0 |
| Sheep and lambs | Hundredweight | 11.35 | | 4.0 | 454.0 |
| Competing commodities previously taxed: | | | | | |
| Jute yarn (cotton) ² | Pound | 17.85 | 2.90 | 1.0 | 178.0 |
| Paper (cotton) ³ | Bags | 108.80 | \$267.00 M | \$95.0 M | 180.0 |
| Open mesh paper (cotton) ⁴ | Pound | 4.05 | 2.14 | .75 | 30.0 |
| Competing commodities not previously taxed: | | | | | |
| Rayon (cotton) ⁵ | Pound | 198.57 | | 1.8 | 3,574.0 |
| Silk (cotton) ⁶ | Pound | 65.80 | | 2.5 | 2,508.0 |
| Spirits (except brandy) | Gallon | 100.00 | | 2.0 | 2,000.0 |
| Grand total | | | | | |
| 120,364.0 | | | | | |

¹ Adjusted for exports and imports of manufactured articles.

² Syrup expressed in terms of raw value sugar content. Since it is chiefly imported, the entire amount is calculated at compensating rate of 1/2 cent per pound.

³ Equivalent rate on product of previous taxes on tobacco used.

⁴ Includes basic commodity with which this commodity competes.

⁵ Approximate average rate for bags of all sizes.

⁶ Includes revenues from taxes upon commodities originating in Puerto Rico, Hawaii, Virgin Islands, and Philippine Islands as follows: Sugar, \$28,650,000; tobacco, \$275,000.

Mr. WALLACE. There are not any further revisions, are there, Mr. Savoy?

Mr. SAVOY. No, sir.

Mr. WALLACE. The suggested rate on wheat is 8 cents a bushel.

Senator KING. Who has to pay it, the farmer?

Mr. WALLACE. That is in the same manner as before. The processor collects it.

Senator BYRD, Mr. Secretary, when you read out the suggested rates I would like you to read the old rates.

Mr. WALLACE. All right, sir. The old rate was 30 cents and suggested rate is 8 cents. Rye is next. In this case the old rate was 30 cents and the suggested rate is 6 cents.

Corn, the old rate was 5 cents and the suggested rate is 6 cents. The CHAIRMAN. What was that?

Mr. WALLACE. The old rate on corn was 5 cents and the suggested rate is 6 cents. In the case of corn there is an increase in the suggested rate.

Senator KING. I suppose it would follow as a necessary corollary that if you impose an excise tax you are going to restrict production, if you put in all those rules and regulations incident to supervision and whatnot.

Mr. WALLACE. The Supreme Court said we cannot do that.

Senator CLARK. That is an economic fact rather than a legal fact, Mr. Secretary. Of course, the cost of production naturally diminishes production, does it not, ordinarily?

Mr. WALLACE. Not necessarily. Agriculture does not follow all the rules that have been taught us by the laissez faire economists that seem to work in the business world.

Senator CLARK. Then as a matter of fact, to increase production would raise the cost of production without any equivalent provision for increasing the price.

Mr. WALLACE. I have not been able to see that that so-called law works in agriculture. I have not been able to see that it works there in the way that it seems to work in industry.

Senator KING. Mr. Secretary, do you contemplate, if Congress should impose an excise tax upon the various agricultural commodities, that there would be, directly or indirectly, openly or in some mysterious and subtle way, an attempt to restrict or control the crop production in those commodities?

Mr. WALLACE. No; I do not see anything of that sort involved.

The CHAIRMAN. You expect to follow the law as written by Congress.

Mr. WALLACE. Yes, sir. As a matter of fact, this matter here is a part of the President's recommendation in his original tax measures. It is a question of raising revenue. You have a desperate need of raising revenue. The question is where to get the money.

Senator KING. Would it not be better to just propose the flat sales tax?

Mr. WALLACE. That is outside of my field. This happens to be a part of the taxation legislation in which agriculture is concerned, and on which I believe agriculture may speak with some propriety, but when you get into the wider field you have gentlemen much better qualified than I.

Senator COUZENS. You were about to start with hogs in your appendix III.

Mr. WALLACE. The old tax on hogs was \$2.25 and the new tax proposed is 30 cents.

Your old tax on cotton was 4.2 cents and the proposed tax is 1.5. The old tax on rice was 1 cent a pound and the new tax proposed is 0.25 of a cent.

On tobacco the tax is broken up into small cigars, large cigars, small cigarettes, large cigarettes, manufactured tobacco and snuff.

Senator COUZENS. You missed sugar.

Mr. WALLACE. The sugar seems to be omitted on my particular copy.

Mr. SAVOY. Here is the revised copy.

Senator GEORGE. There is no change in the sugar.

Mr. WALLACE. The sugar is the same amount.

Tobacco, in the case of small cigars, the old rate per thousand was 13.7 and the new rate is 6 cents per thousand. Large cigars, the old rate was 90.4 and the new rate is 40 cents a thousand. Small cigarettes, the old rate was 12.3 cents a thousand and the new suggested rate is 6 cents. Large cigarettes, the old rate was 16.7 cents a thousand and the new rate is 9 cents. Manufactured tobacco per pound, the old rate was 3 cents and the new rate is 1 cent.

Senator BAILEY. Mr. Secretary, you mean by the "old rate" the previous tax rate proposed under the 1935 amendment or the rates proposed under the original act?

Mr. WALLACE. As I remember it, the 1935 amendment happens to give the rate which had been in existence under the previous acts.

Senator BAILEY. It was graduated down with respect to prices, if I recollect.

Mr. WALLACE. I believe this is the rate that was in the amendment passed in 1935.

Senator BAILEY. The cigarette tax, under the new act, the 1935 act, was 1.9, as I recall it. Now, is this a comparison with 1.9?

Mr. SAVOY. It was 1.9 per pound of tobacco. This is measured by thousands of cigarettes.

Senator BAILEY. You can figure that very quickly. You have got cigarettes, small, 6 cents a thousand. That is 2 cents a pound. So it is higher than it was under the 1935 act. As I understand it, that is 13.

Mr. WALLACE. It is 12.3 cents and 16.7 per thousand, respectively. That was designed to represent a situation that existed under the old act.

Senator BAILEY. I think your 12.3 related to the original act of 1933.

Mr. SAVOY. No, sir; I think that is on January 6, when the act was declared invalid. Those are the rates as computed at that time.

Mr. WALLACE. That would be a question of fact into which we will go for your satisfaction, Senator.

The CHAIRMAN. The total that you propose to raise there is about \$220,000,000?

Mr. WALLACE. \$220,564,000, roughly estimated.

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

Senator BYRD. The Secretary has not finished, has he?

Mr. WALLACE. Do you want to go down over the items?

Senator BYRD. There is a new lot here, that is entirely new.

Mr. WALLACE. Barley had no rate before and it is now proposed to have a 6-cent rate. In the case of these grains there is an effort to have them proportional amongst themselves.

Senator KING. That would be a very heavy tax against beer, would it not?

Mr. WALLACE. You will note it excludes spirits, by the way.

Senator KING. Well, barley is used in the manufacture of beer.

The CHAIRMAN. What else is there now?

Mr. WALLACE. Oats, 4.5 cents. Cattle and calves, 8 cents. Sheep and lambs, 4 cents. Those are all new rates there.

Senator BYRD. Mr. Secretary, to what extent does that increase the cost to the consumer of meat? I notice you have got cattle and calves 8 cents and you estimate the revenue at \$8,656,000. To what extent does that increase the cost to the consumer of meat?

Mr. WALLACE. That goes into that rather difficult economic field again. It must increase the cost to the consumer of meat by as much as, I would guess, somewhere about 1 percent, maybe.

Senator BYRD. One percent of what it is now? You mean it should do that?

Mr. WALLACE. If it were all passed on to the consumer I would guess it would increase the cost to the consumer—well, it would be 8 cents and the present price of cattle on the average, I guess, is about \$8 so I guess it would be about 1 percent.

Senator BYRD. Now, you have got different rates for hogs, cattle, and calves, sheep and lambs. Do they more or less compete?

Mr. WALLACE. Yes; there is a competitive situation there. There was an effort made there to proportion the taxes as between hogs—they have 30 cents, you will note—and the cattle is 8 cents, sheep and lambs 4 cents.

Senator CONNALLY. Are those rates per hundred pounds?

Mr. WALLACE. Those rates are per hundred pounds. That was in an effort to apportionate it to the degree in which they consumed feed grains.

Senator KING. We had a great deal of evidence here tending to show by reason of the tax upon hogs, beef, and so on, the processing tax had strayed a great many of the American people to an enlarged use of fish, because that was competitive, and a larger use of chickens. Are you imposing a tax on fish and chickens?

Mr. WALLACE. No; there is no tax on fish proposed here, and I hope we never attempt to collect the tax on chickens.

The CHAIRMAN. Are there any other items there?

Mr. WALLACE. Jute yarn is 1 cent a pound.

Paper bags, 95 cents a thousand.

By the way, this compares with the old tax on jute yarn of 2.9 cents. The proportion there is roughly proportionate to the production of cotton. In a like manner the paper bags are reduced from \$2.07. You have a situation proportionate to the reduction of the cotton bags.

The open-mesh paper was 2.14 cents a pound and it is now reduced to seventy-five hundredths, or three-fourths of a cent a pound.

Rayon, the new tax is 1.8 cents a pound. That is altogether new.

Senator KING. That is in competition with cotton, the same as jute?

Mr. WALLACE. There have been a great many economic studies made on the competition between rayon and cotton. In certain years at certain times you cannot prove it, and in other years you can prove it.

Senator BYRD. What about the rayon that is made from wood pulp? The rayon in my State is made from wood pulp, not from cotton.

Mr. WALLACE. It is on the theory of competition with cotton, and also on the theory that we do cast around in agricultural products, products that are competitive with agriculture, to have the tax

roughly proportionate, so that the supply and demand situation as between the commodities does not change.

Senator GERRY. That is from whatever source?

Mr. WALLACE. From whatever source.

Senator BLACK. What has been the expense of collecting the taxes in comparison with income taxes, for instance?

Mr. WALLACE. The Bureau of Internal Revenue calculates that expense monthly, I believe. They are able to inform you.

Senator BLACK. I did not know but what you knew it approximately.

Mr. WALLACE. I do not have it in mind at present. It is a well-known figure. Mr. Helvering, do you have that?

Mr. HELVERING. I can give it to you if I have it right here.

Senator BLACK. Would it be less expensive to have an increase in income taxes, inheritances, and corporation taxes?

Mr. HELVERING. The cost of collecting the processing tax is considerably less than the average cost to the Bureau.

Senator BLACK. I know, but what I had in mind was whether or not there are any figures which would show whether a simple increase in the taxes that are now collected such as income and inheritance taxes, and things of that kind, would cost as much or less than the processing tax.

Mr. HELVERING. No, sir.

Senator BLACK. In other words, the expense would be greatly more in collecting our new processing taxes than it would be if we were simply adding to the income taxes to be collected?

Mr. HELVERING. The collection of income taxes is greatly in excess of the collection of processing taxes.

Senator BLACK. As a whole, but we would collect the income taxes anyhow.

Mr. HELVERING. Yes.

Senator BLACK. I was wondering if, for instance, you raise the percentage of income tax, that does not necessarily mean a great increase in the total cost of collecting the income taxes, does it?

Mr. HELVERING. If you had an increase of 5 or 10 percent that would not make an appreciable difference in the total cost.

Senator BLACK. That is what I mean. Then whatever the amount would be of collecting the processing tax, that would likely be in excess of collecting the increased income tax, would it not?

Mr. HELVERING. That possibly is true; yes.

Senator LA FOLLETTE. It certainly would be true, would it not, Mr. Helvering, if it simply involves the changes in the surtax brackets?

Mr. HELVERING. Yes.

Senator LA FOLLETTE. Because you have those returns to go over anyway.

Mr. HELVERING. Yes.

Senator LA FOLLETTE. You can get \$226,000,000 of additional revenue by simply starting the surtax bracket at \$3,000 and 4 percent, and going as we do now, to 75 percent of \$5,000,000 and after?

Mr. HELVERING. Yes; and there would practically be no increase in the cost of collection.

The CHAIRMAN. Mr. Secretary, is there something else?

Mr. WALLACE. I might say, Senator, I was very much surprised by the efficient job that the Bureau of Internal Revenue did in collecting the processing tax. When the figures came in it turned out to be

very much less than I had supposed. I remember there were certain statements made in the old days as to the high expense of this kind of procedure.

SENATOR LONERGAN. Mr. Chairman, may I ask a question?

THE CHAIRMAN. Yes, Senator Lonergan.

SENATOR LONERGAN. Mr. Secretary, on what basis are these proposed rates fixed?

MR. WALLACE. Of course, there is not any one guiding principle. If you will allow me to complete the statement here I think you will find an answer to your question given here.

As a whole, the processing taxes on agricultural commodities suggested would constitute only a very slight burden on consumers, since the total of these taxes if passed on to consumers would represent a very small percentage of the retail prices at which these products sell. In addition, since the proposed rates are, with the exception mentioned, far below the level of the rates previously in effect under the Agricultural Adjustment Act, it is not believed that collection of these taxes would cause any appreciable hardship or burden.

Great emphasis should be given to the fact that each one of the great agricultural programs advocated by farmers since 1920 contained a provision for an adequate and a continuous source of revenue.

This position by spokesmen for agriculture reflected their determination that, so far as possible, their programs should be self-liquidating, and should not, through reliance upon annual appropriations, be subject to political vicissitudes and uncertainties as to Federal farm policy. The continuous source of revenue provided by the McNary-Haugen bill was the equalization fee. The export debenture plan proposed to use tariff revenues. The Agricultural Adjustment Act provided for compensation of the Treasury by processing taxes to cover expenditures required to carry out the production-control programs.

In making up this schedule, roughly, the commodities fall into the following classes:

First, sugar, in which the rate recommended is equal to the processing tax rate, in the main covered by a separate letter. You will recall that, when the sugar tax was levied, there was a reduction in the rate of import duty equal to the processing tax rate. Also, in the case of the leading continental processors, even with a one-half cent tax, their profits would probably amount to between 8 and 10 percent on stated capital and surplus. Without the excise tax, profits would average between 12 to 16 percent.

You see one of the guiding motives there, Senator. I would like to say that one of the guiding motives or one of the things to be taken into account in fixing that particular rate was that with the quotas as at present in effect the sugar processors would be receiving on the average a return between 12 and 16 percent as compared with the return during the late twenties. It averaged, as I remember the figures, roughly 4.5 percent. Is that right, Mr. Savoy?

MR. SAVOY. Yes.

MR. WALLACE. It was roughly 4.5 percent during the late twenties. Under the quota provision, without the tax, they would be getting a rate of between 12 and 16 percent return, and with the tax they would be getting a return between 8 and 10 percent, which has been the rate

they have been getting, roughly, during the past 2 years. So you can see that one of the things to be taken into account in the case of sugar is this situation. It does not happen to be an item which governs in the other cases.

SENATOR HASTINGS. Mr. Secretary, would you think it unwise to make these rates sufficient to pay all the expenses, all the money that is due to farmers under the recent act?

MR. WALLACE. Well, that has not been the approach at all. This has been a separate approach. You see that was the approach under the old A. A. A. The old act was set up so that the money that came from processing taxes would pay the cost of the program.

SENATOR HASTINGS. You think it is unwise to try to get enough out of these processing taxes to liquidate that obligation?

MR. WALLACE. I question whether it would be wise to go that far.

SENATOR HASTINGS. This does not raise half enough for it, does it?

MR. WALLACE. Well, just about half enough.

SENATOR COUZENS. You are departing then from the theory of the agriculturists themselves, that they wanted their program self-sustaining?

MR. WALLACE. Yes; to that extent we are departing from that theory, although I think, in practice, the farm organizations, if they came before you in a hearing, would assent to this program at the present time, but it departs to that extent from the historic position.

THE CHAIRMAN. Permit an interruption, Mr. Secretary. May I say to the members of the committee that we will meet here at 2 o'clock this afternoon, and I hope very much that all the members will be here. Mr. Oliphant, representing the Treasury Department is to go on, and the newspapermen can be here if they desire.

Before we adjourn this morning I shall read a letter that I received from Chairman Jesse H. Jones of the R. F. C. He was requested to give us any views he desired, either by giving it out personally or by writing a letter, so when the Secretary gets through this morning I will present that to the committee.

SENATOR BAILEY. Mr. Secretary, what plan have you to prevent the passage back to the farmers of the processing taxes which you propose here?

MR. WALLACE. There is and can be no plan.

SENATOR BAILEY. Now, under the old law there was no means except by pegging prices, by way of loans the farmer did get the money back through the benefit payments and rentals, but under this plan there is nothing of that sort, is there?

MR. WALLACE. Nothing of that sort; no.

SENATOR BAILEY. Now, he loses, does he not?

MR. WALLACE. That is absolutely right, although you will remember, Senator, in my earlier conversation with you I held to the position that these taxes in the main are passed on to the consumer. That has been the record right along, in spite of the economists to the contrary notwithstanding.

SENATOR BAILEY. You realize that the farmer always thinks that the tax is passed back to him.

MR. WALLACE. The farmer always thinks he is getting unfairly low prices.

Senator BAILEY. Is it not true that the maxim of the trade is that the farmer sells in the buyer's market, he is at the mercy of the buyer?

Mr. WALLACE. The farmer always thinks he is at the mercy of the buyer, and the consumer always thinks he is getting the worst of it.

Senator BAILEY. Is it not a fact that the farmer sells in the buyer's market?

Mr. WALLACE. And the middleman always thinks he is between the upper and nether millstones.

Senator BAILEY. What would you say about that?

Mr. WALLACE. I say we are getting into a metaphysical field.

Senator BARKLEY. To what extent does this program synchronize with the soil erosion, the soil allotment act, and so forth?

Mr. WALLACE. That is altogether separate from it.

Senator BARKLEY. I know it is separate, but you are working out a program under the Soil Erosion Act.

Mr. WALLACE. I would say that the farmers feel that they have obtained under the Soil Conservation and Domestic Allotment Act, signed February 29 of his year, a procedure under which they will be getting, say, \$440,000,000 to \$500,000,000 of money annually.

Senator KING. Who pays for that?

Mr. WALLACE. That is coming out of the Treasury.

Senator BAILEY. He is not going to get it out of these taxes?

Mr. WALLACE. You cannot say whether he is getting it out of income taxes, inheritance taxes, or whatnot. In view of the fact he is getting that benefit I think the majority of the thoughtful leaders of farm organizations would feel that they ought to be, to some extent, as the result of agricultural taxes, contributing. Now, they feel—I do not agree with them—they feel, as you say, that a considerable part of this is passed back to them, that they, in effect, would be paying for the program. I do not agree with them.

Senator CLARK. The farmer would be in a better shape to pay it than he would be without the Soil Erosion Act?

Mr. WALLACE. Yes; I rather think so.

Senator BARKLEY. In other words, it synchronizes to about 50 percent, the payment to the farmers out of the general funds of the Treasury. This money will go into the general fund. If it were earmarked at all it would probably take care of about one-half of the expense.

Mr. WALLACE. Yes; if there was an earmarking provision.

Senator BAILEY. Is that contemplation, that it is going into the general fund for the purpose of sustaining the Soil Erosion Act?

Mr. WALLACE. No; I do not know of any suggestion to that effect.

The CHAIRMAN. The Supreme Court said that that could not be done, that you ought not to try to tie the two together, that you ought to divorce them. This is a separate proposition.

Senator CONNALLY. Mr. Secretary, I notice the rate on hogs is only about one-eighth of the old processing tax. The old tax was 2½ cents and the new one is 30 cents.

Mr. WALLACE. That is \$2.25 and the new rate is 30 cents a hundred.

Senator CONNALLY. Is not that entirely out of line with the other percentages? I notice on cotton it is only reduced approximately one-third, not quite one-third. On hogs it is one-eighth of the former rate. Then you put a tax on cattle and calves, and sheep and lambs, which had no processing tax before.

Mr. WALLACE. If you will just allow me to complete my statement and then we will have a little discussion of the hog tax. I might say with regard to the missing principle, Senator Connally, in this new proportioning of taxes, that is, to some extent on the one hand, to equalize the competitive situation as between the consumers, and on the other hand to equalize the competitive situation as between the different classes of livestock as they consume feed grains.

Senator CONNALLY. You would outbalance it, because if you reduce the hog tax and put on the tax on sheep and cattle that was not there before, are you not unduly helping the hog people?

Mr. WALLACE. Well, Senator, I do not know that you are asking that question seriously. I am quite sure that you would not.

Senator CONNALLY. I do not mean to reflect on anybody, but in not that inevitably the result, that would give an undue competitive advantage to the hog people?

Mr. WALLACE. I do not think you would urge that position seriously, Senator.

Senator BARKLEY. If that were true the situation would be reversed, if you had \$2.25 tax on hogs and nothing on cattle.

Mr. WALLACE. I mean you would come into a little acrimonious controversy between different sections. I feel the suggested rate here is a very fair proportionate rate between the groups. In the Corn Belt you feed the hogs and the hog folks will say, "Why should we pay nearly four times as much as the cattle folks under the new program?"

Senator CONNALLY. You do not reduce the corn.

Mr. WALLACE. We increase the corn a little. There are special things that enter into each one of these rates which would take a long, detailed discussion to go into.

Senator BAILEY. Were the rates arranged, Mr. Secretary, on some special principle, or some definite principle?

Mr. WALLACE. Yes; there is, to some extent, a guiding principle, and to some extent there are special things that enter into each one of them. That is what I am attempting to discuss at the present time. If you will allow me to complete the statement I think some of these things will show forth.

We have just discussed the principle regarding sugar.

In the next class is cigarettes, in which an excise rate equal to approximately one-half of the old processing-tax rate is suggested. Neither wholesale nor retail prices of the leading brands of cigarettes have been reduced since processing taxes were eliminated, and even with a tax at this rate, the profits of the leading manufacturers of cigarettes would average between 10 and 12 percent of the stated capital and surplus. In the case of cigarettes, the tax at the rate suggested would equal approximately 1 percent of the retail price.

Senator BAILEY. You mean 1 percent of the retail price of cigarettes?

Mr. WALLACE. Cigarettes, yes.

Senator BAILEY. I do not quite get your figures. I am sure they are right. There are 3 pounds of the farmer's tobacco in 1,000 cigarettes. You divide the previous tax rate by 3 and you get 411. You have got a 6-cent rate here on a thousand, that is 6 cents on 3 pounds, that would be 2 cents. Now, the rate under the act of 1935 is a graduated rate based on the price in the prior year. It was 1.9

That would be a small increase. I would like to have those figures checked, just to see how the base was arrived at.

Mr. WALLACE. What is the average retail price of a package of cigarettes in this country?

Senator BAILEY. Fifteen cents, that is the regular cigarettes, the majority of cigarettes; 15 cents a package. The price to the wholesaler is 12 cents and the Government gets 6 cents, and there is 6 cents for the farmer, the manufacturer, and advertiser.

Mr. WALLACE. There would be 50 packages in 1,000 cigarettes and the retail price would be \$7.50. \$7.50 would be approximately the retail price of 1,000 cigarettes then.

Senator BAILEY. Yes; that is \$7.50.

Mr. WALLACE. And the proposed rate on the small package is 6 cents, on the large it is 9 cents, it is just slightly over 1 percent for the large packages.

Senator BAILEY. The price in the trade is \$6, but the price retail is \$7.50. Sometimes the price drops to \$5.25. It ranges from \$5.25 to \$7.50. We are talking about the manufacturer.

Now, I would like to get this view from you. The cigarette people did not increase the price of cigarettes; they stayed at 15 cents. The price of tobacco went up, as we all know, 16 cents, then 27 cents, and the last year's average was 20 cents. Who paid the processing tax under those conditions?

Mr. WALLACE. I think perhaps the cigarette people would be able to make a showing under the set-up which I have described previously, that they have absorbed a considerable part of the processing tax. I suspect they would be able to make a showing on that point. That is not the point under consideration here.

Senator BAILEY. You think there would be recovery without regard to that?

Mr. WALLACE. If they can make a showing that they had not passed it on to the consumer or to the merchant, it would enable them to make recovery. But that has nothing to do with the principle I am suggesting here, that inasmuch as they made very good profit even under that situation that they could stand the processing tax of 9 cents a thousand on cigarettes and still have a return of 10 to 12 percent, on the average, on their invested capital and surplus.

Senator BAILEY. Now, the taxpayer would not be allowed to recover would he, if he made substantial profits?

Mr. WALLACE. Yes; under the procedure set up he would be able to make recovery even though he made very substantial profits. That does not enter into that case.

Senator BAILEY. You have an amendment in your appendix to that effect?

Mr. WALLACE. Yes; in the next group are wheat, rye, rice, peanuts, cotton, and tobacco products other than cigarettes. In this group are the commodities on which the taxes are for the most part passed on to the consumer. The rates suggested are from one-third to one-fourth of the old processing-tax rates. Corn has the same economic characteristics as this group but the processing tax previously levied are small (less than 10 percent of the farm price) and, therefore, has been changed but little. The rate suggested for corn is in line with those suggested for barley and oats.

In another group are hogs, on which the tax levied in a considerable measure is passed back to farmers. Here the rate suggested is roughly one-eighth of the old processing tax rate. In addition, a tax is suggested for cattle and calves, sheep and lambs, that roughly corresponds to the tax suggested on hogs, on the basis of the grain consumed by the different classes of livestock.

Additional taxes are suggested for specific products which enter into competition with or are substituted for the products on which processing taxes are levied, such as barley and oats which enter into competition with corn; and silk and rayon which enter into competition with cotton. There is some question as to the amount of competition between silk, rayon, and cotton, but regardless of the extent of the competition it is believed that silk and rayon can bear the small tax suggested.

Spirits are made from sugar, rice, barley, rye, corn, and other products subject to tax. Because of the costs of collections and unequal burdens on processors of these products if taxed separately when used in making spirits, it is suggested that, when such articles are processed into spirits, they be free from the processing tax on the articles, and that instead a flat tax on the production of spirits (except rice spirits, rum and brandy) be imposed, as shown in the attached table. The rate of this tax is roughly equivalent to that which would be received from the spirits if the tax were levied on the products used in making the spirits.

Finally, since the Agricultural Adjustment Act is being amended because of the Hoosac Mills decision, it would seem very desirable, and I hope that it may be deemed proper, to amend that act further at this time, so that only the valid provisions of that act and those provisions necessary to work out the remedial provisions recommended shall remain in effect. I suggest repealing the provisions which appear to be invalid under the decision of the Supreme Court, the striking out of language relating to such invalidated provisions, and the affirming and reenacting of those provisions considered not to have been invalidated. The amendments numbered "3" (except for the amendment to sec. 21 (d)), contained in appendix I, are for this purpose. Those same provisions with respect to the Agricultural Adjustment Act and those now contained in title IV of H. R. 12395 are in substance contained in title IV of S. 4413, now pending before your committee.

That is the end of the statement. I do not know whether you want to take the time to go on.

Senator BAILEY. Mr. Secretary, your main concern is to get enough money to carry out the soil-erosion program. If we levy taxes so that you get the money you are satisfied, are you not? That is your interest in this matter?

Mr. WALLACE. Well, it is a double interest. In the first place, because of the invalidation of the agricultural program and the passage of the soldiers' bonus the Treasury was left in a very bad way, and it was therefore proposed in the original message of the President that various methods be adopted.

Senator BAILEY. Notwithstanding that, if the Congress provides the five or six hundred million dollars that is needed for the soil-erosion program you will not raise any question as to how we raise it,

as to how we raise the money that you want, that what you want is the money, is that not true?

Mr. WALLACE. That is a point, of course. What we want is the money, but we somehow have a feeling that if you do put some money on agricultural products the Treasury will be able to get a little more money and the Senate and House will feel a little more kindly toward the farmers.

Senator BAILEY. All you are doing in getting it out of the agricultural products is you are making the farmers pay.

If we could get it in some other way, where the farmer would not pay, he would get his money free then, would he not?

Mr. WALLACE. I suspect the farmers would feel that the other interests are not completely charitable, so far as he is concerned. While they might show charity for a year, the charity might run out at the end of the year.

Senator BAILEY. We are not dealing with the charitableness of other interests, we are dealing with our own Congress. It is not what they say, it is what we do.

Mr. WALLACE. Concerning that matter it might be appropriate to talk to the representatives of the farm organizations themselves.

The CHAIRMAN. You do not want to have any doubt about getting this appropriation, no matter what legislation we pass for the farmers?

Mr. WALLACE. You read my mind.

The CHAIRMAN. All right. We will divorce that from this proposition.

Senator BLACK. You also think, do you not, Mr. Secretary, that we should adhere, as far as possible, in spite of any decisions that may have been made, to the just canons of taxation, one of which is to place the taxes in such a way that they will not be unjust to those least able to pay, and that the taxes should, as far as possible, be governed by certainty of collection at the least cost, and the burden be placed on those who are most able to bear the burden?

Mr. WALLACE. That is an excellent theoretical statement.

Senator BLACK. Well, it is an excellent fact if it can be brought about. That is what we should strive for in all our tax laws, is it not?

Mr. WALLACE. I think it is, in the main, practical, and a guiding principle. Also I think, Senator, you will discover there are times when exceptions must of necessity be made.

Senator BLACK. There is no reason why the sales tax is bad, if we should adopt it in principle at one time, if we can get the money in some other way.

Mr. WALLACE. I should hate to follow logic on anything completely. I think you would get wrecked if you do.

Senator BLACK. Justice is better?

Mr. WALLACE. Of course I would defend, under the old A. A. A., the processing tax, which was essentially and exceedingly a high sales tax, because under the old A. A. A. there was protection to the consumer, with regard to the ultimate cost to the consumer, that is the consumer was not to pay a higher percentage of his dollar to the farmer, the processing tax included, than was the case before the war. That was involved there. Now, a situation of that sort which tended to bring about a balance as between the groups of our population would be a benefit to the general welfare.

I would say that as large a sales tax as that which existed under the A. A. A. was justified even though it did violate the principles of economists. I think practically all the economists feel that a sales tax is terribly bad, and yet practically every State is using it.

Senator BLACK. There is no excuse for it, however, if it puts the burden on the wrong people, those who are least able to pay it.

Mr. WALLACE. We know that property taxes always bear a higher percentage to the value of the property in the case of the poorer people than in the case of the wealthier people. We find that to be universally true, and yet it is universally done.

Senator BLACK. But there is a movement all over the country to exempt property and therefore you must tax those who are least able to pay.

Mr. WALLACE. That is a very tough thing. Nevertheless, while we are proceeding to the ideal tax procedure you must often find it necessary, for the purposes of State and Federal revenue, to engage in types of taxation which are not completely ideal.

Senator BLACK. That is when you have the majority against you so that you cannot pass the best taxes.

Mr. WALLACE. That may involve a different proposition.

Senator CONNALLY. Mr. Secretary, I have just one question. Is there not a law on the books now authorizing the diversion of a portion of the tariff taxes to foreign relief purposes? Was not that contained in the act?

Mr. WALLACE. In section 32 there is a provision that one-third of an amount equal to the customs receipts should be used for certain purposes.

Senator CONNALLY. Well, if that is true, of course, that fund would supplement any other revenues that would come into the Treasury for use on your soil-erosion program, would it not?

Mr. WALLACE. No; the use of that fund is for certain specific purposes.

Senator BAILEY. Was it not on the export of the manufacturers' raw material rather than relating to the farmers?

Mr. WALLACE. No; it is exports, whether agricultural or manufactured out of agricultural products, and the manufacture is left optional to a considerable extent with the Secretary of Agriculture.

Senator CONNALLY. Is that provision being carried out now?

Mr. WALLACE. Yes; we have done a number of things under that provision. We have subsidized a small quantity of exports intended for the world market, a great deal of them. We have purchased agricultural products that have been unduly depressed in price, and distributed to the people on relief. There has been quite a lot of that. And, as you are aware, we used, oh, perhaps \$45,000,000 of it—the amount not yet exactly known—for cotton, in effect to pay the difference between the sales prices of cotton and the loan. That is where most of it has gone, more than half of it has gone to cotton.

Senator CONNALLY. I was somewhat responsible for the adoption of that provision. That was the Jones amendment in the House, was it not?

Mr. WALLACE. That is right.

Senator CONNALLY. I sponsored it in the Senate. I just wanted to know how far the Department was utilizing that as a source of revenue.

MR. WALLACE. We will be happy, within about a month, to give you quite a complete report on that. We can give you quite a report on it now, in fact.

SENATOR BAILEY. Mr. Secretary, did I understand you to say that you considered the processing tax as a sales tax?

MR. WALLACE. I said in principle it was very similar to sales taxes on a restricted line of products.

SENATOR BAILEY. That is in the sense that they are intended to be paid by the consumer, the ultimate consumer. They are intended to go forward rather than backward. What have we in this act to prevent the tax from being passed back to the farmer?

MR. WALLACE. I do not know of any way with respect to any sales tax, I do not know of any method of making sure as to where the incidence will be. That applies to any tax. I do not know what tax it will be. I think in the case of the income tax you are more nearly sure than anyone else.

SENATOR BAILEY. And the inheritance tax?

MR. WALLACE. Yes, and the inheritance tax. There you can be exactly certain as to where the incidence will be. I do not know what you can do about it.

THE CHAIRMAN. Mr. Secretary, that finishes your statement, does it not?

MR. WALLACE. I merely wanted to mention this, Senator, that I have sent you this letter with regard to the new sugar legislation.

THE CHAIRMAN. That will be placed in the record.

(The letter referred to is as follows:)

HON. PAT HARRISON,

United States Senate.

MAY 7, 1936.

DEAR SENATOR HARRISON: Reference is made to our conference of April 30, 1936, relating to various tax problems, at which time you requested information with respect to a processing tax on sugar as a possible source of revenue.

When H. R. 12395 was under consideration by the Committee on Ways and Means of the House of Representatives, this Department, upon invitation of that committee, recommended that a tax be imposed on the processing of sugarcane and sugar beets, measured by the sugar produced therefrom, at the rate of 0.5 cents per pound of sugar, raw value. It was recalled that a processing tax on sugar at this rate became effective under the Jones-Costigan Act, at the same time as the statutory duty on Cuban sugars was reduced by an equivalent amount. While this tax was in effect, the average price paid by consumers for sugar at retail was less than the average retail price of sugar during the 5 preceding years. This Department recommends this tax to your committee also.

If this tax is levied, the total tax borne by sugar imported from Cuba, the principal foreign source of supply, including the import duty of 0.9 cent per pound of sugar, raw value, would amount to 1.4 cents per pound, as compared with the tariff rate of 2 cents per pound that prevailed for 4 years prior to June 9, 1934, the effective date of the Jones-Costigan Act, and the tax on all other sugar, except the small amount imported from other foreign countries, would be 0.5 cent per pound. The total estimated revenue from the excise and the duty is \$102,000,000. Without this excise, the returns to the Treasury would be confined to receipts from import duties, estimated at \$36,000,000 for the year 1936, which compares with an average of \$76,000,000 in the 3-year period 1931-33.

It will be noted from appendix I, attached, that, at the March and April price level for raw cane sugars and without a processing tax on sugar, unless there is a simultaneous discontinuance of the quota system, the growers' share of the sum of the net return from the sale of beet sugar and Government payments to producers would be reduced from 55.2 percent of the total in 1934 and 54 percent in 1935 to 51.6 percent for the 1936 crop. The processors' share would be increased from 44.8 percent in 1934 and 46 percent in 1935 to about 48 percent for

the 1936 crop. It is then estimated that, without the tax at the rate suggested, the net income of the processors, expressed as a percentage of their stated capital and surplus, would increase from 8.5 percent in 1934 to between 12 and 16 percent in 1936, whereas the estimated return with such a tax in effect would be between 8 and 10 percent.

In summary, if the excise tax on sugar is not put into effect and the quota system is continued, the Government's revenues would be curtailed as indicated above at the same time as the returns of processors would be increased to between 12 and 15 percent of their stated capital and surplus. Such a situation, if continued, in addition to the great improvement in conditions in the sugar industry since adoption of the sugar-quota system and production adjustment, would seem to require consideration of action under section 13 of the Agricultural Adjustment Act, as amended. This section sets forth the conditions under which any of the provisions of the act with respect to any basic commodity may be terminated.

Sincerely yours,

H. A. WALLACE, Secretary.

(Appendix I, referred to in the Secretary's letter is as follows:)

APPENDIX I

Returns to U. S. Treasury from sugar taxes and duties under various conditions, with estimated effects on returns to sugar-beet growers and processors

| Year (calendar, crop, or fiscal, as indicated) | Average prices of cane sugar at New York | | Net return from sale of beet sugar ² (crop-year basis) | Return to sugar-beet growers per ton of beets harvested | | |
|--|---|---|---|---|---------------------|--------------|
| | Cuban 90° raw-duty paid (calendar-year basis) | Refined granulated ¹ (calendar-year basis) | | Processor payments ³ | Government payments | Total return |
| 1925 | \$1.33 | \$5.41 | \$4.70 | \$6.39 | | \$6.39 |
| 1926 | 4.34 | 5.31 | 5.30 | 7.61 | | 7.61 |
| 1927 | 4.73 | 5.08 | 5.10 | 7.67 | | 7.11 |
| 1928 | 4.21 | 5.40 | 4.50 | 7.11 | | 7.08 |
| 1929 | 3.77 | 4.90 | 3.90 | 7.14 | | 7.14 |
| 1930 | 3.39 | 4.40 | 3.42 | 5.94 | | 5.94 |
| 1931 | 2.93 | 3.82 | 2.69 | 5.26 | | 5.26 |
| 1932 | 3.31 | 4.20 | 3.00 | 5.13 | | 5.13 |
| 1933 | 3.00 | 4.38 | 3.50 | 5.18 | \$1.73 | \$6.91 |
| Estimated: | | | | | | |
| 1934 | 3.23 | 4.50 | 3.40 | 5.55 | \$1.65 | \$7.20 |
| 1935 | 3.75 | 4.60-4.90 | 4.25 | 6.28 | 1.60 | 7.88 |
| 1936 | 4.25 | 4.60-4.90 | 4.75 | 6.03 | 1.60 | 7.63 |
| 1936 | 3.25 | 4.60-4.90 | 4.75 | 5.03 | 1.12 | 6.15 |
| 1936 | 3.25 | 4.60-4.90 | 4.75 | 5.03 | 1.83 | 6.86 |

¹ Sources: For 1925-33 U. S. Tariff Commission Report No. 73. For 1934-35 data compiled by Sugar Section. These data are for the calendar years indicated.

² Sources: Same as in footnote 1 above, for average quoted prices which were corrected by Sugar Section to find the average actual sales prices recorded here. The prices for 1934-35 include the tax. These data are for the calendar years indicated.

³ Sources: For 1925-32 from Sugar Section, data taken from form 85-12, for 1926-28 and 1933-35 estimated by Sugar Section on the basis of the relationship to cane-sugar prices in the period 1929-32. Selling expenses and processing taxes paid are deducted from the gross selling price of beet sugar to find the net return recorded here which is divided between processors and growers in accordance with the terms of the contract. It should be noted that these data are not for calendar years but represent the net return from the sale of beet sugar manufactured from beets grown during the calendar year indicated. The selling period for beet sugars under the processor-grower contract extends from the 1st of October of the year in which the crop is produced to September 30 of the following year.

⁴ Sources: For 1926-34 from table 137 Yearbook of Agriculture, 1935.

⁵ Payment for the 1934 crop and estimated payment for the 1935 crop by the Agricultural Adjustment Administration of obligations under former production adjustment contracts.

⁶ Parity price for the 1934 sugar beet crop was \$9.79 per ton. A payment of \$1.75 was made on the basis of an estimate of \$8.94 to be received by growers from processors. Parity price for the 1935 crop was \$9.50. It is estimated that under the former production adjustment contract, parity price for the 1936 crop would have been approximately \$9.75 per ton.

⁷ No tax; 17.5 cents (equal to 40 cents per ton of beets or 20 cents per ton of Louisiana sugarcane) agricultural conservation payment; and 37.5 cents (equal to \$1.50 per ton of beets or 60 cents per ton of Louisiana sugarcane) conditional payment, this being the difference between the tax and the agricultural conservation payment.

⁸ This estimate is composed of an agricultural conservation payment of 40 cents per ton plus a conditional payment of \$1.20 per ton, the sum of which is the equivalent of 80 cents per hundred pounds sugar, raw value.

Footnotes continued on following page.

Returns to U. S. Treasury from sugar taxes and duties under various conditions, with estimated effects on returns to sugar-beet growers and processors—Continued

| Year (calendar, crop, or fiscal, as indicated) | Percent of net return from sale of beet sugar, plus payments by Government, received by— | | Net income of a group of beet processors which includes 75 percent of the industry (fiscal year beginning Apr. 1) ¹⁰ | Net income of group of beet processors as a percent of capital and surplus (fiscal year basis) ¹¹ | Receipts of U. S. Treasury from 1930 and import duties on sugar ¹² |
|--|--|------------|---|--|---|
| | Growers | Processors | | | |
| | | | | | |
| | | | | Percent | |
| 1925 | 55.3 | 44.7 | | | \$124 |
| 1926 | 56.4 | 41.6 | | | 140 |
| 1927 | 53.7 | 45.3 | \$4,414,508 | 3.70 | 124 |
| 1928 | 53.0 | 47.0 | 8,230,230 | 6.85 | 113 |
| 1929 | 60.0 | 40.0 | 5,773,027 | 4.69 | 124 |
| 1930 | 59.4 | 40.6 | -6,290,781 | -6.08 | 112 |
| 1931 | 60.8 | 39.4 | -4,070,359 | -4.41 | 94 |
| 1932 | 48.1 | 51.9 | 2,070,481 | 1.95 | 71 |
| 1933 | 48.0 | 52.0 | 10,724,505 | 10.23 | 51 |
| 1934 | 55.2 | 44.8 | 9,322,251 | 5.61 | 69 |
| Estimated: | | | | | |
| 1935 | 54.1 | 45.9 | \$ 750,000-9,780,000 | 8.0-8.0 | 33 |
| 1936 | 55.0 | 45.0 | 12,520,000-18,000,000 | 12.5-18.5 | 6 |
| 1937 | 51.0 | 49.0 | 12,000,000-18,000,000 | 12.0-18.0 | 40 |
| 1938 | 50.2 | 49.8 | 8,000,000-11,000,000 | 8.0-10.0 | 74 |
| 1939 | 54.0 | 46.0 | 9,000,000-11,000,000 | 9.0-10.0 | 82 |
| 1940 | 51.8 | 48.2 | 9,000,000-11,000,000 | 9.0-10.0 | 102 |

¹⁰ No tax; no payment other than 12.5 cents per hundred pounds of sugar, raw value (equal to 40 cents per ton of beets or 20 cents per ton of Louisiana sugarcane) under the Soil Conservation and Domestic Allotment Act.

¹¹ This price equals the average price of duty-paid raw sugar for March and April 1930.

¹² Estimated payment under the Soil Conservation and Domestic Allotment Act for agricultural conservation in connection with sugar-beet production.

¹³ 50-cent tax; 12.5 cents (equal to 40 cents per ton of beets or 20 cents per ton of Louisiana sugarcane) agricultural conservation payment; and 37.3 cents (equal to \$1.30 per ton of beets or 60 cents per ton of Louisiana sugarcane) conditional payment, this being the difference between the tax and the agricultural conservation payment.

¹⁴ This estimate is based upon the assumption that the price of raw sugar duty-paid would be approximately \$3.75, in the absence of a processing tax, and that the refiners' margin would fall within a range of 85 cents to \$1.05.

¹⁵ Estimated on the assumption that a net actual selling price of from \$4.00 to \$4.50 for refined cane sugar will prevail and that a differential between the net return from the refined beet sugar and refined cane sugar will be close to 45 cents per hundred pounds, which corresponds approximately to such average differential for the crop years 1929-33, inclusive.

¹⁶ These estimates are made on the assumption that 300 pounds of refined beet sugar is recovered per ton of sugar beets and that under the processor-grower contract the grower will receive approximately 50 percent of the net return from the sale of the sugar after deducting all selling expenses and any processing or excise tax paid.

¹⁷ 40-cent tax; 12.5 cents (equal to 40 cents per ton of beets or 20 cents per ton of Louisiana sugarcane) agricultural conservation payment; and 24 cents (equal to 75 cents per ton of beets or 36 cents per ton of Louisiana sugarcane) conditional payment, this being the estimated amount required to give growers "parity price" for the 1936 crop.

¹⁸ The estimated payment of 40 cents for agricultural conservation plus an additional payment of 75 cents per ton that would be required to bring the grower's total return up to an amount equal to what is estimated would have been the parity price for the 1936 crop of sugar beets under the former production adjustment contract.

¹⁹ 40-cent tax; no payment other than 12.5 cents per hundred pounds of sugar, raw value (equal to 40 cents per ton of beets or 20 cents per ton of Louisiana sugarcane) under the Soil Conservation and Domestic Allotment Act.

²⁰ These estimates assume approximate continuation of the prices and processing taxes that existed in 1935.

²¹ Sources: Moody's Manual of Industrials and the Manual of Sugar Companies, published by Fawcett & Co. covering approximately 75 percent of the domestic beet industry. The fiscal year does not coincide with the crop year, but covers the period Apr. 1 to Mar. 30.

²² Data for the period 1925-33 represent the gross collections as indicated in U. S. Department of Commerce publication Foreign Commerce and Navigation, less payments for drawbacks.

²³ Data for 1924 represent net import duty collections of \$27,000,000 and processing and compensating tax receipts of \$32,000,000 making a total of \$59,000,000 from which no disbursements for benefit payments were made during calendar year 1924; but payments were made in 1925 on the 1924 crop.

²⁴ Data for 1925 represent an estimate of net collections of import duties on sugar of \$35,000,000 plus an estimated revenue from processing and compensating taxes of \$65,000,000, giving a total of \$100,000,000 from which it is estimated disbursements of \$75,000,000 were made as benefit payments on the 1924 and 1925 crops, which would leave an estimated net revenue from import duties on the 1924 and 1925 crops of \$25,000,000.

²⁵ Data for 1936 include an estimated net revenue from import duties for the year 1935 of \$23,000,000, processing and compensating taxes, if enacted at 50 cents per hundred pounds, raw value, of sugar, of \$68,000,000. From the estimated revenue for 1936 in the various cases there is deducted an amount equal to the payments indicated for the 1936 crop. Two disbursements to be made in 1936 are not deducted, namely, the payments to be made under the provisions of the Supplemental Appropriation Act, fiscal year 1936, of obligations incurred under former production adjustment contracts, and payments to be made under the Soil Conservation and Domestic Allotment Act. Net Treasury receipts, in these cases involving conditional payments, would be approximately \$4,000,000 larger than those shown if the rates suggested in appendix II are adopted.

The CHAIRMAN. I would like to read a letter I have received from Mr. Jones, Chairman of the Reconstruction Finance Corporation. [Reading:]

DEAR SENATOR HARRISON: This Corporation has been requested to give some impression to your committee as to its attitude and opinion with respect to the fairness or advisability of exempting from the tax imposed by H. R. 12395 the adjusted income which bank holding company affiliates may be required to retain in order to comply with the provisions of guaranty agreements which they have entered into with this Corporation in connection with investments made by the Corporation in their subsidiaries.

If it is shown in any case that strict compliance with the provisions of any such agreement will impose an unfair burden upon the holding company, the Corporation will consent to reasonable modifications in the provisions of the agreement. Insofar as any of the rights and investments of this Corporation are concerned there would, therefore, seem to be no reason for suggesting any change in the bill, especially in view of the fact that section 15 of the bill already makes special provision for income which is required to be retained pursuant to agreements entered into prior to March 3, 1936.

I should like to add that the proposed manner of taxing banks seems entirely fair and highly desirable, in that while it requires banks to pay some additional taxes, it permits them to strengthen their capital structure, which is in the public interest.

I have not had time to study the bill carefully, but if substantial concessions could be made that would encourage modernization, new plant construction, and new buildings to replace old ones, new equipment for railroads and industry of all kinds, including allowances for new debts created for these purposes, the employment situation, and business generally would in all probability be greatly helped, and society much better served.

You and your experts will know best the necessary formula. But, to illustrate, if a dollar so used, whether from earnings or borrowed money, could in substantial part be deducted in arriving at the adjusted net taxable income, the taxpayer would be encouraged to improve plant and equipment, thus stimulating the movement of capital goods and the employment of labor.

Sincerely yours,

JESSE H. JONES, Chairman.

We will recess until 2 o'clock.

(Whereupon, at the hour of 12:20 p. m., the committee recessed until 2 p. m. of the same day.)

AFTERNOON SESSION

(The hearing was resumed at 2 p. m. pursuant to recess.)

The CHAIRMAN. Mr. Oliphant, you may proceed.

STATEMENT OF HERMAN OLIPHANT, GENERAL COUNSEL FOR THE TREASURY DEPARTMENT

Mr. OLIPHANT. I understand the request of the committee, transmitted through its chairman, was to, as he put it, to come down here and answer all of the objections that have been made to this bill by all of these witnesses during the public hearings. That, obviously, is a very large order, because there have been a great many witnesses discussing a great many aspects of the bill, and able witnesses, thoughtful witnesses, people who have wanted to be heard and have seen to it that they have been well represented,— and that is all to the good.

But if I am to reduce that job that you assigned me to manageable proportions, both for the standpoint of the committee's convenience and also for my own, I will have to proceed according to plan.

My thought is that I can save you time if I would just take a few minutes to sketch the principles underlying the bill, and I am addressing myself now to the tax on corporate earnings, and then take up in a

very brief memorandum the seemingly more important objections which we have gathered from having some 15 men in the Treasury go over, read, and re-read, and re-read this testimony. And then I shall be prepared, or those with me will be prepared to answer as far as we can, questions that the committee may care to ask.

I would like to say at the outset, so far as the general idea underlying the tax on corporations, corporate earnings is concerned, that when I am as old as that idea is, I will probably be dead. Its principle was embodied in our original income tax law during Civil War times, it was considered by committees of Congress in 1917, it was up for vote in 1921, and substantially this plan was adopted in the Senate in 1924, I think it was.

But to come to the specific tax proposal, and how that proposal was formulated, along with other proposals, and submitted to the President for his consideration in the discharge of his duty to make recommendations for taxes to the Congress, I might say this: that it is the work of a great many minds. There are as you know, in the Bureau, a number of men constituting a staff whose business it is constantly to work on possible tax legislation. A great many suggestions are received there during each year, a great many questions come up in connection with the application of existing taxes, and there is a mechanism here whereby all of those flow to a place where they can be examined and the more promising ones garnered out for possible future use.

This proposal went through that process, and I propose to describe very briefly something of what that process was like.

The problem confronting the Treasury was the disarray into which the Budget picture was thrown by the invalidation of the processing tax and by the passage of the soldiers' bonus. There has been a lot of talk about balancing the Budget, but the Treasury's immediate responsibility in formulating this tax proposal was the more immediate problem of putting the Budget picture back into the situation it was prior to those two events, because the primary concern of the Treasury is to see that representations made on behalf of the United States Government to prospective purchasers of its securities shall be made good, and under our system of government, the mechanism for making those representations is the President's Budget message.

So the Treasury confronted the real problem, and the President's immediate problem of finding the necessary temporary revenues to take the place of the shortage in collections during the current year, and the necessary permanent revenue to provide for the permanent agricultural program and for the liquidation of the soldiers' bonus over a period of 9 years.

Senator HASTINGS. Is it or not correct that approximately 499 millions of dollars was set up in the Budget to take care of these payments to the farmers, and something like 276 millions of dollars, as I recollect it, for the C. C. C. were in what you call the emergency budget of the present year, and that they have been transferred to what you now call the permanent budget for 1937?

Mr. OLIPHANT. I wish I were in a position to answer that question. Obviously the man who can answer it authoritatively would be Mr. Bell, the Acting Director of the Budget, and I am sure he would be glad to attend at your convenience.

Senator HASTINGS. Are you familiar enough with the Budget to know that that is a fact?

Mr. OLIPHANT. I should like to avoid if I could, going into a detailed discussion of the bill, merely because that lies outside the realm of such competence as I have, and I would not want to make statements here without the approval of the Director of the Budget, and other persons responsible for that situation.

That was the immediate problem confronting the Treasury, and it was just as real as maintaining one's good faith ever is, whether that is the good faith of an individual or the good faith of the Government.

So, we in the Bureau of Internal Revenue and in the Treasury Department, looked around to see what the possibilities were of obtaining such a large additional sum of money and realizing that Congress was going to be called upon to exercise a power which I think in its solemnity is exceeded by few powers, other than the power to make war and peace, namely, the power to impose taxes.

Our approach to that problem was this: Let us frame the tax measure so that the burden of the tax will fall in that area and upon that portion of the population where it will create the minimum of hardship. That brings you at once to this question. After all, taxes have to be paid by individuals. When all is said, taxes come out of the pockets of individuals.

From what sources can individuals pay taxes? Except for minor items, there are only four. They can get funds with which to pay taxes from business profits; they can get those funds in the form of receipts from rents; they can get them from interest; and they can get them from wages and salaries. There are no other possibilities, if you exclude minor items such as royalties and things of that sort.

The problem then is, on each of these four sources from which people can pay taxes, where should the major part of this new money required be taken in order to produce a minimum of hardship upon the population, the people as a whole? What do the figures show?

They show, first, that the people's receipts from interest are going down with the falling interest rates in this period of easy money into which we have entered. They show, second, that the taxpayers' receipts from rents are but slightly up; they are up but only slightly. They have just begun to recover.

And they show, third, that the people's receipts from salaries—and we can disregard wages largely, because most income tax payments out of wages and salaries come out of salaries rather than out of wages—that such increase as we have had in business profits, to which I shall allude in a moment, has not yet had time to get itself reflected in a corresponding increase in people's salaries. As we emerge from this depression there has been, as we have emerged from all previous depressions, a lag between an increase in the business profits and an increase in the salaries paid out of those business profits.

That leaves the fourth item, business profits, and on that it is gratifying to note how substantial the increase in business profits is. This is in no sense an attack on business profits. We welcome it, because increased business profits means increased business activity and the means of increased employment, and increase of employment, I dare say, is the problem that lies nearest to the heart of every

man in this room if he adjourns all other considerations except considerations for the public good.

What are the dimensions of the increase in business profits? Reliable figures from impartial sources show that corporate profits during 1935 were 42 percent above those in 1934. They show also one of the most reliable index reporting profits of corporations, that during the third quarter of 1935, business profits were 69 percent above business profits during the third quarter of 1934. They show that in the fourth quarter of 1935, the increase over the corresponding period in 1934 was 117 percent. Figures for the first quarter of 1936 are not available. Preliminary estimates indicate a substantial increase, not as great as the last increase that I mentioned.

So that if the additional tax burden is to fall in that area where the increased burden which the Congress is called upon to lay will produce the least hardship, the major part of the increased revenue must come from business profits, in the absence of any corresponding increase in the three other sources from which people pay their taxes.

So we in the Bureau and in the Treasury, seeing what the dimensions of the increase in business profits was, turned to the next problem. Upon what part of that field, and upon what portion of all of the people of the country receiving the increased business profits, should the major portion of the additional burden be placed if we are to produce the minimum of hardship?

Business profits are received by three groups of people; by the owners of individual businesses, by partners, and ultimately by the stockholders of corporations. There are a total, according to the last census figures available, of 450,000 corporations in this country. There are a total of individual businessmen and individual partnerships of 1½ million, to use round figures. The gross sales of production of corporations comprising the whole national figure for this year, 1933, was 142 billion, and the gross sales of production of the individual enterprises and partnerships was 30 billion.

The first thing that occurred to us and to anybody else approaching the problem in the same way, is the fact that those engaged as individual businessmen and as partners are bearing the full tax load of our graduated surtaxes. Are those receiving business income from corporations, doing so? The answer to that question, which surprised the Treasury when they found it, to my mind, makes no other form of taxation at this juncture possible of defense.

On our estimates—and past performance shows their dependability—if corporate profits during the year 1936, all of them, went out to the stockholders and passed through the personal income-tax mill as opposed to part of them being paid in the form of a corporation tax, the total of that is the figure you have had of over \$4,000,000,000. That is, if those profits all went to stockholders and we applied our present graduated surtax rates to them, they would produce enough additional revenue to provide for the permanent needs of the Government at this time, over 620 millions of dollars.

So that is where we wound up. We found increase in business profits with no corresponding increase in rents, salaries or interest, business profits coming from individual enterprises or partnerships now paying the full income tax load, and enough corporate profits not carrying the full surtax load which if made to do so, would pro-

vide a total of 620 of millions of dollars, stated by the President to be required at this juncture.

Senator HASTINGS. Mr. Oliphant, have you the amount of taxes paid by corporations for 1935?

Mr. OLIPHANT. Yes; we have those figures.

Senator HASTINGS. Was it not about a billion one hundred million? Has it not been stated that the corporate tax was about a billion one hundred million dollars?

Mr. HAAS. We are estimating for the calendar year of 1936, corporate tax, total corporate tax of one billion one three two million.

Senator HASTINGS. And that is an increase over 1935 of how much?

Mr. OLIPHANT. I cannot say offhand, but it was an increase.

Senator HASTINGS. What I was trying to get at, Mr. Oliphant, is this: If there is an increase in the business as you say, I was trying to find out how much would be the increase in taxes under the present rate?

Mr. OLIPHANT. I will have to leave to Mr. Haas a discussion of the details of the estimates. I should say this, however, that all of those estimates, that is the past performance of the Treasury which the Secretary gave to the committee when he was down here, as well as this estimate, takes into account the probable increase in business activity, and reckoning with the probable increase in business activities, this tax will produce according to the Treasury's estimates 623 millions of dollars of additional revenue.

The CHAIRMAN. And the figures of 1 billion 132 million, if you would leave the flat rate, embrace the increase in business also?

Mr. HAAS. That is right.

Senator HASTINGS. If the increase in business is 45 percent, would the increase in taxes be approximately 45 percent?

Mr. OLIPHANT. I do not think I can answer that.

Senator BYRD. Does that include the windfall tax?

Mr. OLIPHANT. The windfall tax is a separate tax.

Senator CLARK. The 623 millions is the corporate surplus tax alone?

Mr. OLIPHANT. That is the corporate surplus tax alone. Put it this way. If you take the total of corporate earnings during 1936—this is purely a hypothetical statement—and distribute them all to the stockholders so that they all pay the same surtaxes—that the stockholders pay the same surtaxes that everybody else has to pay, or if they are unpaid in the corporation and you impose a corporate tax which is the mathematical equivalent, it will produce all of the additional money that is required for permanent purposes.

Senator BYRD. Wait a second. What do you mean by "permanent purposes"?

Mr. OLIPHANT. I am using a shorthand expression. To take care of specifically the payment of the soldier's bonus spread over a period of 9 years, and to finance the permanent agricultural program recently enacted by the Congress. Those two items.

Senator BYRD. Does it not include relief and public works?

Mr. OLIPHANT. No. I was confining myself to the specific request made by the President in his message.

Senator BYRD. Your estimates are general. Have you broken them down to any specific corporations? Take the American Telephone & Telegraph Co. What effect will this tax bill have upon the payment of taxes by that company?

Mr. OLIPHANT. I have not brought data on that with me, because my understanding is that the Secretary will be here tomorrow in response to a double request from the committee, namely the effect of this bill upon the taxes of certain corporations that have been enumerated, and the effect of the bill upon certain corporations that may lie back of those corporations that have not been enumerated.

Senator BLACK. And certain individuals who lie back of those corporations.

Mr. OLIPHANT. I have not read the copy of the request.

Senator BYRD. You prefer not to discuss that today?

Mr. OLIPHANT. I have not the data here. In fact, a very large army of people were working on getting it ready for you in time for tomorrow.

Senator BYRD. I will ask you one question. If a company today is paying out more than its earnings, and under this proposal it naturally follows that they will certainly reduce the dividend payments to what they do earn, because they would not want to diminish their surplus when the possibility is there, or when they are certain that the Government will tax them so that they cannot establish another surplus, or will tax them an excessive rate to replenish any surplus that they may diminish in the form of paying out those dividends.

Mr. OLIPHANT. The purpose of this bill is to bring about this situation, that if the earnings of any corporation are fully distributed, that will include the case you cite, so that if the stockholders are paying the surtaxes that everybody else has to pay, then a corporation would not pay the tax.

Senator BYRD. Yes; but you do not answer my question. The American Telephone & Telegraph Co. in the year 1934 paid out 46 million more than it earned. That 46 million went to the stockholders and was taxed, of course, in the returns of the stockholders. Do you not think that the American Telephone & Telegraph Co. from now on will only pay out those earnings and not pay out any surplus in the form of dividends?

Mr. OLIPHANT. Assuming that figure is correct, that it corresponds to figures in the Bureau, which I suppose will appear tomorrow, I assume that is true.

Senator BYRD. I ask you that with respect to any corporation.

Mr. HAAS. I think, Mr. Senator, it would be somewhat dependent upon the cost of money and also upon the fiscal policy of the corporation. A corporation, when it decides to pay dividends and keep them up regularly on stock, has in mind that they have to go to the stockholders for new funds, therefore they have some specific fiscal reason for keeping regular dividends up. They will still have that in mind under this bill.

Senator BYRD. Let us discuss the American Telephone & Telegraph Co. Do you think that they would be compelled to keep up a certain rate of dividends in order to secure the necessary finances that they may desire?

Mr. OLIPHANT. The bill does provide for a carry-over in case in a particular year they pay an excess of dividends over earnings. They are credited with that in a subsequent year. That is section 27.

Senator CLARK. Do you mean if the corporation depletes its surplus for the purpose of paying dividends over its earnings in a certain year, then they are credited for that amount and permitted to recoup their surplus in that amount in subsequent years?

Mr. OLIPHANT. Yes.

Senator BYRD. It is only when the surplus is depleted to a considerable extent. The surplus of the A. T. & T. is 142 millions. I ask you as a tax expert if you think that the A. T. & T. will continue to pay out more than they earn if this bill passes, as a matter of prudent administration?

Mr. HAAS. I would think, Mr. Senator, as I said a moment ago, whether or not the A. T. & T.—there are certain factors which determine that decision, and I think one of the important factors is that they have to go to the stockholders—they do now—in the last 10 years if I remember the figures correctly, they issued through the issuance of stock rights, about 950 millions of dollars. The investment public if they desired continuing dividends, that would be a major factor in determining its policy, and they might during a period of prosperity, sell out sufficient stock rights to have a surplus if they pay instead of in a manner which corresponds to applying back earnings—they will probably pay out all of their earnings.

Senator BYRD. Do you admit that a substantial strong company can pay dividends, and can sell rights, and thereby establish a surplus, whereas a weaker company cannot?

Mr. OLIPHANT. That is one of the objections raised in the testimony, to which I am coming later on.

Senator BYRD. I want to ask you the specific question and I want to take 1934 and assume that our figures are correct, that the A. T. & T. earned \$121,000,000, and paid out \$167,000,000. What will that corporation pay if they continue that policy in the form of taxes, under this bill?

Mr. HAAS. Mr. Senator, I view a corporation as a group of stockholders—

Senator BYRD (interposing). I am asking you what the A. T. & T. will pay?

Mr. HAAS. If they pay out all of their earnings, the A. T. & T. according to my way of thinking, that a corporation is just a group of stockholders—

Senator BYRD (interposing). I want it by the records that now stand. The A. T. & T. is credited with paying certain taxes now, on the books of the company. I want to know if they will pay if the policy is continued?

Mr. HAAS. I would answer that question by saying that the A. T. & T. as a corporate unity if it does pay out all of its earnings, or any other company, would not have to pay any tax; but A. T. & T. has to go behind it and we have to look at it realistically. They are just a group of stockholders. Those stockholders would be paying more revenue to the Government than it is now paying.

Senator BYRD. How will they be paying more if the A. T. & T. is already paying out more than it earns?

Mr. HAAS. If the earnings of A. T. & T. are going directly to individuals and are being taken up in their individual income taxes, your statement is absolutely correct, but if the A. T. & T. earnings are going into another corporation and personal holding companies, and so forth, then—

Senator BYRD (interposing). What about a charitable institution? If you do not tax at the source, which you are now doing—eliminate that tax and then the stock is owned, stock of the A. T. & T. is owned

by a school or a church or some charitable institution, what effect will that have?

Mr. HAAS. Insofar as stocks are owned by tax-exempt charitable institutions, those will escape taxation.

Senator BYRD. Have you figured how much that will be?

Mr. HAAS. We have made allowances for that in the estimate.

Senator BYRD. I would like to have that broken down and see how much you figure would go into nontaxable institutions, such as charitable institutions, churches and schools, and so forth.

Mr. HAAS. I could not do it offhand.

Senator BYRD. You admit then, that if the A. T. & T. continues the dividend policy of 1934, as a corporation they would not pay any taxes?

Mr. HAAS. That is very clearly in the bill, but realistically they would pay taxes.

Senator BYRD. I differ with you there, because the earnings are already being distributed by the A. T. & T.

Mr. HAAS. Do you know, Mr. Senator, whether or not any of these earnings are received by corporations?

Senator BYRD. Do you know?

Mr. HAAS. No. I was not sure.

Senator BYRD. But you have made an estimate on something you have not gotten all of the information on it.

Mr. HAAS. Well, we will get it again, Mr. Senator. We take into account all corporations you see.

Senator BYRD. How many of the 600,000 stockholders of the A. T. & T., in your judgment, are in the taxable brackets? In other words, assuming we abolish the corporate tax on the A. T. & T. as this bill does, and they continue their present policy and they distribute this money to 600,000 stockholders, which it does; how many of those 600,000 will pay taxes and be in the taxable brackets?

Mr. HAAS. Now, Mr. Senator, I cannot answer that. We did not make our estimate up by taking the A. T. & T., the Allis Chalmers and all the different corporations of the country and then add those up. We based our estimate on reports which come in the Bureau of Internal Revenue and we have taken the totals, and from those we have worked. But for each specific corporation, we did not attempt to find out how the tax would operate. That would have been a tremendous job and would not have been worth while, because we can arrive at our estimate from the total much more readily.

Senator BYRD. The point I want to make, Mr. Chairman, is that with respect to the A. T. & T. especially, they will cease to pay any dividends out of their surplus, and to that extent, of course, will reduce the dividends. It would be very foolish for any company to take dividends out of surplus and then be taxed to establish another surplus.

Senator BARKLEY. Let us take this A. T. & T. case, which seems to be one that is emphasized here. It is no more true of that company than any other corporation similarly situated. Assume that they pay out now all of their earnings in dividends, they are taxed 15 percent of the total of their earnings before distribution. After distribution, each shareholder pays on his individual income tax which is increased by the receipt of the dividends from the A. T. & T.

Mr. HAAS. That is right.

Senator BARKLEY. That is perfectly simple. There is nothing complex about it, and of course if this bill passes, the A. T. & T. will pay no corporate tax as long as it distributes its entire earnings to its stockholders.

Mr. HAAS. That is right.

Senator BARKLEY. But suppose next year it decided not to distribute any at all; to keep it all or to keep half of it. Then it would not be able to get off with a 15 percent tax, but would pay whatever tax the bracket of that earning would provide for in the bill.

Mr. HAAS. That is right.

Senator BARKLEY. And the other cases are of corporations almost as important as the A. T. & T., which makes no distribution at all now but keep all of their earnings, would be required under this bill to pay more than the 15 percent tax which they now pay.

Senator BYRD. Does the Senator from Kentucky feel that the A. T. & T. with 452 million surplus today, will want to add to that surplus and pay as much as 22 percent if they do not pay any dividends?

Senator BARKLEY. I do not know if they will, and so far as I am concerned I do not care. But the A. T. & T., which is probably an objectionable illustration because of its size, is now paying a 15 percent corporate tax, and the average shareholder is paying whatever the tax is that he pays on his distributed share of that corporate income, whereas there are large corporations that are making no distribution at all now are paying only 15 percent, which is the same as the A. T. & T. is paying, and the stockholders are paying nothing because they get nothing. It is impossible to level this proposition off, it seems to me, without relieving somebody of a corporate tax that is now paying a corporate tax.

Senator BYRD. What you have done is to level it off to relieve the rich corporations which already have surpluses?

Senator BARKLEY. If this change in the taxable principle on which we are levying taxes on corporations is a just and fair system, the fact that it may relieve some big corporation of a tax in a form in which it is now paying, seems to me to be of no consequence. You may lose a little levy by relieving the A. T. & T. or some other corporation of the corporate tax that it now pays provided it continues to distribute all of its earnings, but you are catching somebody else who is not distributing its earnings, and it evens itself up in the long run.

Senator BYRD. The A. T. & T. is one of many that will be relieved. Any corporation which has a large surplus and pays its earnings out will be relieved.

Mr. HAAS. One of the important factors in Senator Byrd's inquiry will come out tomorrow, and that is that you have not many of these large corporations making large distributions of earnings. The next question is, where are the earnings being distributed, and that will come up in the discussion tomorrow.

Senator BLACK. Do you know how many associates and affiliates and interlocking corporations the A. T. & T. has?

Mr. HAAS. I do not know.

Senator BLACK. That will come out tomorrow?

Mr. HAAS. I believe so.

The CHAIRMAN. In your estimates, did you take into consideration these dividends that are paid to charitable and educational institutions?

Mr. HAAS. Yes, sir, Mr. Chairman, we did. Dividends going out of that figure of somewhat 4½ billion dollars we estimated dividends going to tax-free sources, in other words, people with low incomes who would pay no taxes, and it is better than 700 million. People who would pay no taxes, and to charitable institutions.

The CHAIRMAN. That is the present law, is it not?

Mr. HAAS. They are exempt under the present law.

Senator BARKLEY. Let me ask you this—

Senator BYRD (interposing). Excuse me, Senator. They are exempt from the present law, but the corporation pays the tax now at the source. This bill would relieve the taxable source in many instances, and therefore these charitable institutions would pay no tax at all. They now pay it as stockholders in a corporation.

The CHAIRMAN. I want to know if in his estimate that they have taken that fact into consideration, and he says he has.

Senator BARKLEY. Let me ask you this. Without regard to what this bill may do to some individual corporation, I think we all might as well admit that some of them will pay less corporate tax than they now pay, some of them may not pay any, which now pay, but taking them as a group, in making your estimate of the net income to be raised by this bill, did you take into consideration that certain corporations that are now paying taxes will not pay corporate taxes after this bill is passed, if they continue to distribute all of their earnings or if they inaugurate the policy of distributing all of their earnings?

Mr. HAAS. Yes, sir, we did. In fact, we worked out the estimate on this basis: That if a corporation, all corporations in the aggregate for the country as a whole, retained 10 percent; if they retained 15 percent; and 20 percent. We adjusted the rates in such a manner that in either case in any of those instances we would get our increase of \$620,000,000.

Senator BYRD. Let us take for example the three Standard Oil Co.s, the Standard Oil Co. of Indiana, California, and New Jersey. They are not interlocking. They have aggregate surpluses today of \$948,000,000. In 1934, they would have paid an average of about 7 percent in taxes by the distribution for that year. What is to prevent these companies with these enormous surpluses from continually and for the future to come, of paying out their earnings, and thereby not paying any taxes at all?

Mr. HAAS. The corporation itself, as I said, may not pay taxes. You see, you do not have the complete picture, Senator, until the Treasury has fulfilled your request for this other information. You would have to know just where the stockholders of these Standard Oil Co.s represent individuals. O. K.; if they are individuals, then they are subjected to the regular surtax mill. If they are corporations owned by individuals, then you have an entirely different story, and you won't know that until tomorrow.

Senator BYRD. Will the information tomorrow take up a company like the A. T. & T. and the Standard Oil Co., and tell us who the largest stockholders are and how much more they will pay?

Mr. HAAS. I understand that is the request.

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

Mr. OLIPHANT. That concludes my general statement of principles of equality in the taxation that underlie this bill, and I can sum it up

by saying that with the fact now known that there has been business increase, and there has been this increase in business profits without a corresponding increase in the other sources from which income taxes can be paid, and the further fact now known that the total additional permanent revenue required for these purposes can be obtained by stopping the avoidance of surtaxes through the corporate device—

Senator COUZENS (interposing). That is the important question. I have never been able to get an answer to it. How much is there of that?

Mr. HAAS. \$620,000,000.

Mr. OLIPHANT. \$620,000,000.

Senator COUZENS. You do not mean to tell this committee that there is \$620,000,000 tax avoidance through the conservation of excess earnings?

Mr. OLIPHANT. Yes.

Senator COUZENS. I doubt that statement because I have not seen any proof of it.

Mr. OLIPHANT. I will be glad to have Mr. Haas discuss that phase of the estimate.

Senator COUZENS. I cannot conceive that as a fact. I have seen no estimates.

Senator HASTINGS. Mr. Oliphant, how much would you have to increase the present rate on the same basis without doing anything more to change it than to change the rate, in order to raise the \$620,000,000?

Mr. OLIPHANT. I understand if we propose to lay this added tax burden equally on all corporate earnings by a mere increase in the corporate income tax, that that rate would have to be 25½ percent.

Senator CLARK. You mean you would have to raise the present income corporation tax to 25½ percent?

Mr. OLIPHANT. To produce this amount of additional revenue. That is true if the capital-stock tax is repealed.

Senator BAILEY. On what basis of national income do you figure that, Mr. Oliphant?

Mr. OLIPHANT. You do not mind my passing that question to the man who can give you a better answer?

Mr. HAAS. The estimate of \$623,000,000 additional income to be received provided this bill went into effect is based upon a corporate income of \$7,200,000,000, and I could give you a like comparable figure over the series of years, or you can form your own judgment whether or not you think that is a reasonable estimate.

Senator BAILEY. How does that compare with last year?

Mr. HAAS. Thirty percent greater than last year. One of the witnesses that was here testifying and discussing the estimates said that he felt that our estimate of additional yield under the basis of the new bill was too high, and his main reason for believing this was that this estimate which I just gave you was too low. We were a little stunned at the Treasury; it is not an infrequent occurrence that we have experts disagreeing with us, but you cannot make estimates mechanically. We have made voluminous studies of the relationship between different economic theories, but in the final analysis you use this background and the estimates are finally arrived at on the basis of our informed judgment.

Last fall when the President put out his budget summary, the budget was attacked, the estimates were attacked, and we had this type of thing appearing in the press. You probably noticed it—by an expert, which expressed the opposite opinion of this witness I am speaking of who appeared here before the committee. He said at that time—that was last fall:

It is to be hoped that the estimated increase will be actually realized, but however, however high may be our hopes, the fact remains that the revenue collected up to the 4th day of October of this year was but \$28,000,000 greater than the revenue collected during the same period in the fiscal year 1935. Can it by any chance be that the estimate of the revenue has been deliberately overstated?

This expert thought it was too high, and this expert that testified recently thought it was not high enough. On this expert's expression, we do know what the result has been. Instead of being overstated, our actual income-tax receipts and the receipts which he was talking about here, are a little over 1 percent more than the estimate.

Senator BAILEY. What about the accuracy of that statement that the corporate income this year is only \$28,000,000 as compared with a similar quarter last year? I gathered that from that statement. Is that accurate or not?

Mr. HAAS. You are judging that on the basis—

Senator BAILEY (interposing). I am asking you.

Mr. HAAS. In this statement which I just read?

Senator BAILEY. Yes.

Mr. HAAS. I will repeat the statement that I read—

The CHAIRMAN (interposing). He was just wrong, was he not?

Mr. HAAS. He is just absolutely wrong?

Senator BAILEY. Which one was wrong?

Mr. HAAS. They were both wrong.

Senator BAILEY. What was the increase in corporate income? You say that statement is wrong. Let us get the truth.

Senator BARKLEY. You would not have the increase for the first quarter of this year in the Treasury and you won't know anything about it until the income-tax reports of next year are known?

Mr. HAAS. That is correct. Senator Bailey, he was referring to the first quarter of the fiscal year beginning last July.

Senator BAILEY. And that was \$28,000,000 in excess—

Mr. HAAS (interposing). And he used that as evidence to discredit our estimate at that time. He contended that they were deliberately raised.

Senator BAILEY. The excess for the first quarter of the fiscal year 1935 was \$28,000,000 more than—

Mr. HAAS (interposing). The point is we make our estimates for 1 fiscal year.

Senator BAILEY. You say he is incorrect. I will take your word for it, but you are not answering the question. Can you tell me what was correct?

The CHAIRMAN. They came within 1 percent of their estimate. They collected 1 percent more than they estimated.

Senator BAILEY. This is a matter that happened something over 9 months ago. Can you tell us the fact?

Mr. HAAS. Yes.

Senator BAILEY. What was it?

Mr. HAAS. This expert said that we deliberately elevated the estimate.

Senator BAILEY. I am not saying that.

Mr. HAAS. We actually know the results because the time has elapsed. We were 1 percent off. The receipts were 1 percent more.

Senator BAILEY. What were the figures?

Mr. HAAS. I will have to supply those. I do not carry them in my head. I will put those in the record for you.

Senator BYRD. What was the percentage of the total earnings of corporations distributed last year in dividends?

Mr. HAAS. In 1935?

Senator BYRD. I understood 70 percent of the total earnings of corporations are being distributed now in the form of dividends?

Mr. HAAS. You see, Mr. Senator, the 1935 data as they come in through the corporation reports, income-tax reports, are not yet available.

Senator CLARK. When you say 70 percent is distributed, what year was that?

Mr. HAAS. This expression of 30 percent retained is a figure which can be arrived at by taking an average number of years. I think that is what works out for the last 10 years or something like that.

Senator CLARK. For the last fiscal year on which you have figures, what did the 70 percent amount to, and what did the 30 percent amount to in dollars and cents?

Mr. HAAS. Senator, that relationship of the amount retained and the amount paid out changes with the stage of the business cycle. When you get in a depression a much larger proportion of the earnings are paid out than you pay at the top.

Senator CLARK. All right. Just on the last fiscal year which you are taking into consideration, what does the 70 percent amount to, and what did the 30 percent amount to in dollars and cents? We are requested here to raise a specific amount of money. You say that the President's figures, his request was for \$620,000,000. By some strange coincidence this particular tax has been stumbled on which also raises \$620,000,000, and I am trying to find out what the basis is on which you arrived at the \$620,000,000?

Senator COUZENS. "Stumbled on" is right.

Senator BARKLEY. It is hardly correct to say that this \$620,000,000 is the amount of money that the tax is raising, because that is not accurate.

Senator CLARK. I understood it to be the testimony here that this particular tax in this particular bill would raise \$620,000,000.

Mr. HAAS. Would raise \$623,000,000.

Senator CLARK. \$623,000,000 then; in addition to what we are getting now. I would like to know the basis on which that is figured?

Mr. HAAS. I would like to go through, Mr. Chairman, if you want us to review this whole estimate again, and we would have to do it to convince the Senator. But you will have to take another day for it. It is all in the record.

The CHAIRMAN. I would like to say that Mr. Oliphant appeared here with a chart and gave an explanation to the committee the early part of last week, showing exactly how they raised this additional \$623,000,000.

Senator CLARK. I would like to get an answer to that question, Mr. Chairman. The particular years that they took on this formula of 70 and 30, which arrived at \$623,000,000?

Mr. HAAS. Mr. Senator, I can answer the question without going into the whole complicated estimate. The formula does not assume any particular percentage of distribution.

Senator BARKLEY. I understood you to say the other day and repeated it here today, that his 30 and 70 is a sort of an average arrived at over a period of 10 years without regard to any one year. It might be any different percentage in any one year, but over a period of 10 years, that is what it figures up.

Mr. HAAS. That is correct.

Senator CONNALLY. Your theory of this bill, as I understand the theory of the proponents, is that the percentage which is distributed does not make any difference. In the total under this bill the tax would be the same—whether it is distributed or whether it is not distributed—when it finally gets in to the taxpayer and is paid into the Treasury, it will be the same amount?

Mr. HAAS. That is right.

Senator CONNALLY. So therefore it is immaterial as to what percentage they retained and what they did not.

Mr. HAAS. That is correct. As far as the revenue is concerned, it does not make any difference.

Senator BYRD. What disturbs me is how you estimated the amount of taxpayers who would receive dividends. How many million stockholders are there in these different corporations in the country?

Mr. HAAS. We have also given information on that, Senator Byrd.

Senator BYRD. How many are there, roughly?

Mr. HAAS. I do not recall offhand, but we know from the income-tax return tabulations in what income classes the dividends fall, and our information on that is every bit as good as the mortality tables on which life-insurance companies base their business.

Senator GERRY. You have a lower bracket, and I asked how many taxpayers were in that lower bracket, of the corporations that were earning less than \$10,000 a year. How many stockholders? I think you said you did not know but that you thought you could get that. Have you been able to get that?

Mr. HAAS. We have worked on that, Senator, and we cannot get the number of stockholders because one man owns a number of shares of stock in various different companies. We can get the number of individuals who receive dividends, from our statistics, but we cannot answer your question. We went over there and tried to make a new tabulation, but we just do not have that data. But that particular data as to the number of stockholders is not necessary in the computation of this estimate.

Senator GERRY. No; but it is important as showing how many stockholders who receive dividends from corporations that are earning less than \$10,000 a year, and comparing this number to those of the large corporations. There may be a great many more. I do not know. Possibly there may be a great many more stockholders, for example, in these very large corporations, like the A. T. & T., which has been mentioned, or in others—some of the utilities—there may be a great many more of them receiving dividends from these than from the smaller corporations.

Mr. HAAS. I am sorry. There is just no data available which will answer that. I see why you are asking for it.

Senator GERRY. You said you thought you might be able to give it to us.

Mr. HAAS. I thought we could get it by running through some new tabulations, but it is not on the returns.

Senator BARKLEY. When an individual taxpayer gives his return, he does not give the number of shares he owns in any corporation, but he gives the amount of his income. He may even give the source of it. And when the corporation pays its tax into the Treasury, the corporation does not say how many stockholders it has or how much it has distributed to John Smith or Bill Jones. So there is no information contained in either the individual or corporate returns from which you can obtain the number of stockholders?

Mr. HAAS. That is right.

Senator BARKLEY. In order to obtain it, you would have to go to some other source?

Mr. HAAS. That is right.

Senator GERRY. If the Senator from Kentucky will permit me, I did not go to that question, but the Treasury said they thought there was some outside source that had the information, and I think it would be interesting to have it, and I thought the Treasury might get it.

Mr. HAAS. We have examined it, and to date we have not been able to find anything.

The CHAIRMAN. All right, Mr. Oliphant; you may proceed.

Mr. OLIPHANT. Now, as I say, we have gone over, there in the Treasury, these hearings very very carefully. We have two things as the result of it, the end product of that examination. We think that the criticisms directed to the complexity of the schedules have much to be said for them, and working on an idea which I think Mr. Parker worked out, we have here in mimeograph form, a single page covering rates which with such modifications as your own experts may think advisable, will replace 10 pages of rates, et cetera, in the bill.

The CHAIRMAN. This gets the same results absolutely as in the four schedules of the House bill?

Mr. OLIPHANT. By adopting one of the tables and putting in it the possibility of a flat exemption to small corporations of a certain number of dollars. The amount of that possible exemption is left blank, because the necessary calculations have not been made to suggest how far you could go in the amount of the dollar exemption of the corporation. How high you can go with that and how low you can come in the size of the corporation to which you will give that exemption. I do not want to mention any figures, because they are likely to get confused in people's minds.

(Following is the proposed possible substitution presented by the witness:)

POSSIBLE SUBSTITUTE FOR SECTION 13 (c) AND (b)

(P. 14 to p. 24, line 13, of comparative print)

Sec. 13. Tax on corporations.—(a) Definitions: As used in this title—
(1) The term "adjusted net income" means the net income in excess of the credit provided in section 26 (relating to interest on certain obligations of the United States and Government corporations); and

(2) The term "undistributed net income" means the adjusted net income minus the sum of—

(A) The dividend credit provided in section 27; and
 (B) A specific credit of —; except that such credit shall be allowed only if the adjusted net income is not in excess of —. If the adjusted net income is in excess of —, the tax imposed by this section shall not exceed the tax which would be payable if such specific credit were allowed, plus the amount of the adjusted net income in excess of —.

(b) Rate of tax in general: There shall be levied, collected, and paid for each taxable year upon the adjusted net income of every corporation a tax equal to the sum of the following:

Two-sevenths of the amount of the undistributed net income which does not exceed 14 per centum of the adjusted net income;

One-third of the amount by which the undistributed net income exceeds 14 per centum and does not exceed 20 per centum of the adjusted net income;

Three-eighths of the amount by which the undistributed net income exceeds 20 per centum and does not exceed 45 per centum of the adjusted net income; and

One-half of the amount by which the undistributed net income exceeds 45 per centum of the adjusted net income.

The CHAIRMAN. We would like to know how to raise this \$623,000,000 additional. Will it bear an exemption of \$1,000 of \$20,000, or \$15,000, or what?

Senator HASTINGS. Do you expect to suggest the amount later to the committee?

Mr. OLIPHANT. Those calculations are in the process of being made, and I am just told here that it is safe to say that it could be as much as \$1,000 on corporations with incomes of \$20,000, and the calculations we are now making is—how much higher could that sum be raised?

The CHAIRMAN. Do not find it much higher. We need more revenue.

Mr. OLIPHANT. We will attempt for this occasion as on other occasions to decide the responsibility which we assume for the estimates and do the best we can.

The CHAIRMAN. On this basis, we can raise \$623,000,000 on this method?

Mr. OLIPHANT. That is right.

The CHAIRMAN. And simplify the proposition?

Mr. OLIPHANT. That is right.

Senator CONNALLY. Is that on the first year of a corporation, Mr. Oliphant?

Mr. OLIPHANT. That is a different question. During the calendar year 1936, there will accumulate a tax liability to the United States to the full sum of \$623,000,000. I think that clarifies a thing that I am sure everybody has been trying to make clear.

Senator BYRD. Does your new schedule bring in exactly the same amount?

Mr. OLIPHANT. We are running calculations to see what amount of exemption, on what size corporations, will produce the \$623,000,000.

Senator BYRD. Are you prepared to show that this schedule would bring in \$623,000,000?

Mr. OLIPHANT. Yes; we are prepared to say, and that there can be an exemption there. How much, you do not want me to say now, I am sure.

The CHAIRMAN. You are settled at least on a \$1,000 exemption up to \$20,000 net income?

Mr. OLIPHANT. That is right.

The CHAIRMAN. We may go a little higher than that exemption and get \$623,000,000?

Mr. OLIPHANT. That is right.

The CHAIRMAN. When will you let us know definitely about that? Senator CONNALLY. You said that there will accrue for 1936 a tax liability to the Government of \$623,000,000?

Mr. OLIPHANT. Yes.

Senator CONNALLY. Do you make a distinction between the liability and what the Government will receive?

Mr. OLIPHANT. No. Merely a difference of when it will receive it.

Senator CONNALLY. It will receive it in March 1937, will it not?

Mr. OLIPHANT. As I understand these figures—and I easily get beyond my depth when I get into figures—whenever you change the income tax, since you report on a calendar year basis, of course you always get a certain amount of lag in the time at which you actually get the money into the Treasury.

Mr. HAAS. They pay in installments.

Mr. OLIPHANT. Yes; they pay in installments.

Senator BARKLEY. Of course, the new rates carried in this bill may or may not take effect for the whole calendar year and become effective for the fiscal year? You won't raise the total amount during the calendar year 1936, would you?

Mr. HAAS. Mr. Senator, the House bill now has it so that it is effective from January 1, 1936. That is the tax year. Whatever is due, the first installment of it is due March 15, the following year.

Senator BARKLEY. So that you must collect the tax as of March 15 subject to whatever installment payments would bring about a delay for the whole calendar year 1936?

Mr. HAAS. That is right.

Senator COUZENS. May I ask Mr. Oliphant if he is going to read this statement that he has submitted here?

Mr. OLIPHANT. I am happy to follow the wishes of the committee.

The CHAIRMAN. This is an explanation of this new schedule, is it not?

Mr. OLIPHANT. No.

The CHAIRMAN. This memorandum that you are speaking of now or which you are submitting now?

Mr. OLIPHANT. If I might come to that. The thing is that the last-minute amendment in the House changing the dividend year so as to make it coincide with the taxable year will, as we see it, necessitate a revision of section 27 (i) in the bill so that I mention those two matters at this time: The simplification of the schedules, and a further revision of 27 (i) relating to intercorporate dividend taxes.

As I say, we have gone through all of this voluminous testimony and have boiled it down and tried to get to what seemed to us the objections of greater importance and more serious weight, and after that had all been boiled down, that was subjected to further summation, and I have here a relatively brief statement of those particular objections, and what may fairly be said on the other side. I am prepared to make any disposition of that statement which the committee desires.

Senator LA FOLLETTE. I am anxious to hear it, as one member of the committee.

Senator BYRD. Before you start reading that, Mr. Oliphant, as I understand it, a corporation that has a debt greater than its surplus is placed in a 22½ percent class. Now, let us take two corporations—this has impressed me very greatly. Two corporations that have a

surplus of \$100,000. Let one have a debt of \$101,000. That corporation gets the 22% percent rate.

Mr. OLIPHANT. That is on the \$1,000 only.

Senator BYRD. Let us say that they owe \$200,000. Then they get 22% percent on \$100,000. Suppose another corporation has a debt with \$100,000 surplus, of \$90,000. By the terms of its indebtedness it is compelled to pay all of its earnings, by contract, each year. Then that corporation would have to pay 42 percent. Is that correct?

Mr. TURNER. Unless the contract came within the provisions relating to—

Senator BYRD (interposing). Suppose it had no contract, but a mortgage coming due and that mortgage took all of its earnings. And that particular corporation, because the debt was a little less than the surplus, would have to pay 42 percent. To my mind that is a tremendous inequality.

Senator LA FOLLETTE. As I understand it, the Treasury is not responsible for the so-called cushioning provisions of this bill. The cushioning provisions were written in by the Ways and Means Committee. If the Senator is arguing about taking out the cushion provisions because they do not seem to be equitable, as I understand it, the Treasury has no position as far as these cushion provisions are concerned.

Senator BYRD. He is defending the bill as it stands, and I want his suggestion as to how to remedy this gross inequality as I see it, in the bill.

Senator LA FOLLETTE. As I understand Mr. Oliphant here, he does not defend the complexities of the bill.

Senator BYRD. If he does take that position, I want him to give the committee his opinion as to how we can correct this inequality.

Mr. OLIPHANT. I start out personally with the proposition that I have a hard time distinguishing between this corporation over here which is in debt, and the partnership or the individual who is in debt.

Senator BYRD. You do not believe in cushions?

Mr. OLIPHANT. The House in going over that, and we rendered every assistance we could to the committee, felt that an adjustment ought to be made.

Senator BYRD. Do you approve of the cushion of the Ways and Means Committee?

Mr. OLIPHANT. If this committee wants to go into that matter, we will render every assistance that we can.

Senator BYRD. What is your personal opinion as the general counsel about this cushion business? Are you for it or are you against it?

Mr. OLIPHANT. That is a pretty broad economic question that I would rather not answer at this time.

Senator BYRD. It was not in the original bill that you prepared, and it was put in by the House. I certainly think we are entitled to your opinion whether you are for or against any cushions for debts.

The CHAIRMAN. It is one of the things that is really worrying the committee very much. I know it worries the chairman of the committee very much. If this new schedule that has been submitted here should be substituted for the four schedules submitted by the House, then the question arises, what are we going to do with these

debt-ridden corporations? So it is a question of very great importance to us, and if you have any views on it, we would like to get them?

Mr. OLIPHANT. I will be glad to prepare an answer to that question and submit it to the committee. I do not want to extemporize on that question at this time.

Senator BYRD. You do not want to say yes or no to that question, whether you are in favor of or against cushions for debts?

Mr. OLIPHANT. I find in my work there are very few questions that can be answered in an illuminating fashion yes or no. I prefer at this time not to try to extemporize an answer to that serious question.

Senator BYRD. Will you prepare a memorandum?

Mr. OLIPHANT. I will.

Senator BYRD. Will you deal with these companies that owe a little less than the surplus, as well as those that owe more than the surplus?

Mr. OLIPHANT. I will ask Mr. Tierney to make a particular note of those companies.

Senator BYRD. In this bill there is a difference of 20 percent.

The CHAIRMAN. And in your answer, I wish you would give to us whether you think there should be a distinction between debt-ridden corporations paying 22 percent, and one that is free from debt paying on 15 percent.

Senator BLACK. Is there any provision of law now made for a distinction between a debt-ridden partnership or an individual, and one that is not debt-ridden?

Mr. OLIPHANT. No; they are all the same. Partnerships are all the same. Individuals are all the same.

Senator BYRD. And they are all taxed in proportion to their income, which this bill does not do with respect to corporations.

Senator BARKLEY. Is there any distinction in law now between a debt-ridden man and a non-debt-ridden man as to his paying taxes on his net income?

Mr. OLIPHANT. None, except in the amount of interest he has to pay on the debt, and Helvering looks at him with a glass eye.

The CHAIRMAN. Have you anything to say there in your statement about that question?

Mr. OLIPHANT. No; I will cover with with an appropriate memorandum.

The CHAIRMAN. You may proceed.

Senator KING. Some of us have been on the floor of the Senate, and that is the reason we are not here.

Mr. OLIPHANT. I am sorry you were not here, sir.

As I say, I will run over briefly what we deem the more important of these criticisms of the bill and indicate briefly what we think in all fairness can be said on the other side, and since they have a very wide ramification, I appreciate very much the extent to which you will bear with me in allowing some of these questions to be answered by those who have been working with me on these questions, because there is a limit to what you can keep in mind on questions of this magnitude.

Now, in the first place it has been urged by many witnesses that this bill does not represent an honest attempt to balance the Budget. I am omitting that introductory paragraph.

Senator CONNALLY. This next one, we all know is not going to balance the Budget.

Mr. OLIPHANT. Well, I hope it is going to keep faith with the present and prospective purchasers of Government securities.

Senator COUZENS. Let us read it. It has been criticized.

Mr. OLIPHANT. Any such attempt must begin first on the expenditure side. To answer this objection I need only briefly recapitulate the history of the bill. The President, in his Budget message, stated that he did not contemplate requesting of Congress any additional taxes at this session but that any expenditures additional to those provided for in the Budget ought to be financed by new taxes. And he had at other times referred to the possible invalidation of the existing tax. Since that time, the Budget as set forth in the President's message has been seriously upset by the invalidation of the Agricultural Adjustment Act and the passage of the soldiers' bonus legislation. This bill is intended only to restore the Budget to the position which it occupied prior to these upsets. Such reasons as may exist for a thorough review of our expenses so that they may be equated to our probable revenues existed last December before either of these events occurred and have not been changed one way or another by the circumstances which have led up to the consideration of this bill. I ask, therefore, that in all fairness the bill be considered from the point of view only of the limited objective set forth in the President's special Budget message, and that the matter of general budgetary balance should be treated on its own merits essentially as it would have been had this legislation not been necessary.

The second criticism: Are the Treasury estimates dependable?

Secondly, a word about the criticism which has been made of the Treasury estimates. In the first place, quite a bit has been made of the fact that only about half of the estimated revenue from incomes in the calendar year 1936 will be secured by the Government during the fiscal year 1937—i. e., that the estimated increase of revenues for the coming fiscal year will be only \$310,000,000 instead of \$623,000,000. There is nothing novel about that. This necessarily follows an enactment of any income tax because incomes are customarily reported for calendar years, whereas the fiscal year of the United States runs from July 1 to June 30. The same difficulty would be present if we should raise the rate of the present corporation income tax, or increase the rate of the normal individual income tax or raise the rates of the surtaxes in the lower brackets or resort to any other new form of income taxation.

Finally, still addressing myself to the estimates, I have no doubt but that you have all been impressed by Mr. May's criticism of the Treasury's estimate of the proportion of corporation income which would be distributed in 1936, assuming a continuation of present law. Mr. May, you will recall, agrees substantially with the Treasury's estimates of the total income, but challenges the Treasury's estimate of the amount which will be distributed. Mr. May bases his challenge primarily upon a consideration of the average amount of statutory net income distributed by corporations over a period of years.

Many witnesses for the opposition have stated that averages are deceptive, and I believe that here we have a particular instance of that. Treasury estimates were based not merely upon a consideration of averages but on a consideration of the particular phase of the

business cycle in which we now find ourselves. The proportion of corporation net earnings disbursed as dividends characteristically varies with the different phases of the business cycle—dividend disbursements substantially lagging behind net income, so that they fall behind it during periods of revival and run ahead of it during periods of decline, the net resultant of these variations being the averages which Mr. May and other witnesses have quoted. In estimating the distribution for 1936, the Treasury has not merely considered past years generally but has studied selected years in the business cycles which are considered most closely analogous with the year 1936. When all is said and done our best assurance as to the dependability of these estimates is the Treasury's past performance, and the record of that is before the committee.

Senator BYRD. What are the years? I am very much interested in that.

Mr. HAAS. Well, there are several years. One that I recall off-hand was somewhat analogous to it, and that was 1922. There were other years that we studied when we were emerging out of the depression.

Senator BYRD. 1922 was the rising time, as I recall.

Mr. HAAS. 1922 is sharply rising.

Senator BYRD. I would like to be supplied with the details on that.

Mr. OLIPHANT. Will you give that information?

Mr. HAAS. Yes.

Mr. OLIPHANT. All right. We will get that information.

Senator KING. Before leaving that, did you take into account, in the observations which you have just made, that further statement of Mr. May in which he called attention to the alleged difference of approximately a billion dollars between the statements submitted by the Commissioner and the statements submitted by the Secretary of the Treasury?

Mr. OLIPHANT. That was considered and the Secretary I think addressed a letter to the chairman of the committee indicating that there had been a somewhat unfortunate use of terms, that instead of saying "withheld for stockholders" the term should have been "not received by stockholders." Is that letter in the record?

The CHAIRMAN. That letter is in the record.

Mr. OLIPHANT. Thank you. In the next place, a number of witnesses who have suggested that objectives of this bill might be better attained by a stiffening of sections 102 and 351. I might first note in passing that all these suggestions have been couched in general terms and that no specific and concrete proposal for strengthening these sections has been presented to the committee. Frankly, I doubt the judgment of the people who advocate this as a real solution, since this Committee knows how great are the difficulties and how sparse have been the results of years of experimentation with these sections.

Even assuming, however, that these sections could have been provided with a real backbone, we would not have attained the objectives of this measure and those who so state, I believe, misunderstand these objectives. As typical of such misunderstandings, let me take Mr. May's classification of all corporations into three groups—namely, (1) the large group of small corporations which he states do not in any event constitute a source of tax evasion, which statement of his I repeat without proving, (2) the group of corporations, small in number

but great in importance, which are publicly owned and whose dividend policies, according to Mr. May, are not at all governed by tax considerations, and finally (3) the small group of large closely held corporations against which he states the bill is directed. Mr. May compares the bill with Herod's massacre in which there was a great slaughter of innocents in an attempt, ineffectual in that case, to reach a single individual. Likewise, in this case, Mr. May contends there will be a widespread slaughter of innocents—the small corporations and their stockholders and publicly-held corporations and their stockholders—in order to reach a few offenders. Mr. May's analogy is poorly put, for I assure you that there will be no slaughter of innocents if this bill is adopted, and there are many using corporations to avoid surtaxes. Contrary to the supposition of Mr. May and of so many of the witnesses who have appeared in opposition to it, the bill is not directed solely against conscious tax evasion.

We are not interested in the motive of tax evasion but in the fact of lost revenue to the Federal Government which occurs when corporation earnings are neither distributed to stockholders and so subjected to the individual income tax, nor subjected to a compensatory tax in the hands of the corporation. Every corporation which would be subject to the proposed tax, those falling in Mr. May's first and second groups equally with those falling in his third, and the incorporated pocketbooks back of any and all of them would be equitably subject to it on this principle, and the contrary impression so widely prevailing among the witnesses who have appeared before this committee is based upon a complete misapprehension of purposes of the measure.

Does the bill favor the strong against the weak?

Next, I believe we should take up the allegation urged by practically every witness who has appeared in opposition to it, that this tax would stunt the growth of small and struggling corporations and discriminate against them and in favor of large and well-established corporations. I might first call your attention to the fact that, while you have heard a great deal from people who have heard that large and powerful corporations desire this tax in order to stamp out their small competitors, or who have heard of people who have heard of this, no representative of a large corporation appeared before you to advocate this tax. On the other hand, representatives of large and powerful corporations have appeared before you to oppose this tax out of solicitude for their smaller brothers. I am surprised they did not employ the over-worked widows and orphans.

Let us look at the facts. We have urged that corporations, both large and small, can secure such capital as they need for the conduct of their operations by the sale of stock, either to stockholders or others, distribute notes to stockholders, or by distribution of optional stock dividends as provided in section 115 of the bill.

Senator BAILEY. That is one of your main points?

Mr. OLIPHANT. That is part of it.

Senator BAILEY. Under your theory the small corporation could always be able to sell stock and therefore get capital. Is that not your view of it?

Mr. OLIPHANT. Yes.

Senator BAILEY. Not by way of surplus earnings but by way of selling stock. That is the crux of this whole argument. I will just stay

along with you if that is true, I will go along with you; but if it is not true then I have got to hesitate. I will tell you, I do not see how a small corporation can sell stock. I know of none in America today that are selling stock.

Senator KING. May I add right here, Senator, that the last record put out by the Securities Exchange Commission shows a very small sale, I think it is 5 or 6 or 7 percent of the issues of other years, and very much lower than Germany, Switzerland, France, Great Britain, or almost any other European country.

Senator BAILEY. I am willing for Mr. Oliphant to show me. I will go along with you. Show me how the small corporation, in lieu of money by way of savings, would be able to expand by way of selling stock. If that is easy to do, if that is feasible, I think it is all right. I would like to hear you on it.

Mr. OLIPHANT. If you will permit me to continue.

Senator BAILEY. Yes.

Mr. OLIPHANT. I am as eager to come to grips with that problem as anybody is. Nobody wants to do anything rash. This is not a game we are playing. I should like, if I may, to continue my general statement on this criticism and when I have finished it I will then address myself further to that question.

The CHAIRMAN. Go ahead. You may proceed.

Mr. OLIPHANT. The stock to be sold to stockholders could, of course, be taken up out of the cash dividends disbursed to such stockholders in an amount equal to the earnings which would have been directly reinvested in the absence of the tax. Mr. Ballentine urges that this proposed methodology is impractical since up to 79 percent of the dividends so distributed will be taken by the Government in income taxes and so will not be available for resubscription. This is, in fact, the case to the extent that such dividends fall in income brackets of individual distributees in excess of \$5,000,000 but relatively few small and struggling corporations have principal stockholders whose incomes range to these figures.

Senator BYRD. How many income taxpayers are there with incomes of \$5,000,000 and in excess of that amount?

Mr. OLIPHANT. I will give you the nearest figure I have. The estimate for 1936, under the existing law, there will be 86 income-tax payers with incomes in excess of \$1,000,000. They are paying on an average income of \$2,120,000.

Senator COUZENS. You mean \$5,000,000 instead of \$1,000,000, do you not?

Mr. OLIPHANT. I have only the figure for \$1,000,000. I am giving you the best figure I have.

The CHAIRMAN. That is 86 income-tax payers?

Mr. OLIPHANT. Eight-six.

Senator BAILEY. You say "relative few small and struggling corporations have principal stockholders whose incomes range to these figures", that is, \$6,000,000. That is just the point that I want to address myself to. They have incomes of less than 1 percent of \$5,000,000, or one-tenth of 1 percent. If they had stockholders who had great big incomes they might sell them some stock, but they have small stockholders with very little income. You say you will address yourself to that later.

Mr. OLIPHANT. Yes; and to complete such partial answer to your question as I have here.

Under the proposed tax it is estimated that there will be an additional 212 individual income taxpayers with incomes in excess of \$1,000,000, making a total of 298, and that group of 298 would pay on an average income of \$2,360,000.

The CHAIRMAN. You mean in the event that this bill passed?

Mr. OLIPHANT. In the event that this bill passed. That is the estimate of the group of income taxpayers above \$1,000,000.

Senator BYRD. How did you calculate that? On what basis did you make that calculation? Is that on the assumption that all dividends or earnings are going to be distributed?

Mr. OLIPHANT. Full distribution.

Mr. BYRD. You know that cannot occur.

Mr. OLIPHANT. Well, under the bill, from the standpoint—

Senator BYRD (interposing). Wait one second. You can retain 30 percent of the earnings and pay the same tax you pay now, namely 15 percent, and to base estimates on the assumption that every dollar of earnings is going to be declared in dividends is ridiculous on the face of it. You say you base these particular estimates on that.

Senator CONNALLY. What you mean, Mr. Oliphant, is you will have enough squeezed out of the corporation into the hands of the individual taxpayers to increase the number to 298.

Mr. OLIPHANT. Yes.

Senator BYRD. I want him to tell us how he made that up. If he does it on the assumption that all earnings are going to be paid out in dividends I think it is an erroneous assumption.

Senator COVENS. I think you overlook the fact that they impose a compensatory tax on the corporation that equalizes the assumption of complete distribution.

Senator BYRD. Are your assumptions based on the complete distribution of earnings in this particular estimate?

Mr. OLIPHANT. The statement I just made is based upon a complete distribution of all earnings.

Senator BYRD. You know that is not going to occur, do you not?

Mr. OLIPHANT. If it does occur under the bill the amount of taxes which the corporation will pay will compensate that loss of revenue, what would otherwise be that loss of revenue to the Federal Government.

Senator HASTINGS. It would make your number receiving over \$1,000,000 income less?

Mr. OLIPHANT. That is right.

Senator BLACK. But it would make the income to the Government the same.

Mr. OLIPHANT. That is right.

Senator BYRD. Let us go into that a little. What does a man with an income above \$1,000,000 pay? It is 73 percent; is it not?

Mr. OLIPHANT. We have the effective rate right here.

Senator BYRD. Under this bill a corporation can pay from 1 to 42 percent in accordance with how it distributes its earnings, and 42 percent is not equal to 73 percent. Even though all their earnings were retained they would pay 42 percent, which this proposition would not do. As a matter of fact, what will happen will be that a great many corporations will completely avoid paying taxes and others

will pay 7, 8, or 9 percent. That is a different matter from 73 percent. If a millionaire would have stock in some company and the company would pay the rate, the company would probably pay 10 percent, whereas if it was given to the millionaire he would pay 73 percent, and your estimate is based on the complete distribution of all earnings.

Mr. OLIPHANT. You are right in pointing out the magnitude of present surtax avoidance. It was based on the assumption either that all earnings were distributed or that the corporation would pay that all earnings were distributed or that the corporation would pay an equivalent tax. I do want to emphatically state that my reference to that hypothetical case, which I see now could have been much clearer, does not concern at all the Treasury's estimate that this tax will produce \$623,000,000.

Senator BYRD. What I take issue with you on, Mr. Oliphant, is where you say it makes no difference in the return that comes to the Treasury whether these earnings are distributed or not distributed. That is the statement you just made. It makes a good deal of difference, because in this instance the individual would pay 73 percent and the corporation withholding it may not pay over 5 percent.

Mr. HAAS. When Mr. McLeod was here he presented to the committee—you were probably absent, Senator Byrd—he showed various rates that if the corporation held a certain amount they would only pay a certain rate. It is all equalized all the way down the line at various percentages of distribution. A particular corporation may not fit in, but in the aggregate we get the same average percentage, whether it goes outside or whether it stays inside, regardless of the percentage retained in the corporation.

Senator BYRD. I would like to have Mr. Oliphant correct the record. He made the statement with respect to these two-hundred-some-odd millionaires, 212 millionaires, that it would make no difference to the Treasury, that the Treasury would get just as much by the corporations not distributing as by the corporations distributing.

Mr. HAAS. That is in the aggregate.

Mr. OLIPHANT. That point is extremely well taken. I appreciate that. Shall I proceed.

The CHAIRMAN. Yes.

Mr. OLIPHANT. For most small corporations, the amount which will be available for resubscription would be substantially larger under the proposed plan than under the present law.

Senator BYRD. Let me ask you just one question. Do I understand that all your estimates are based on the theory that all earnings are going to be distributed, or just the 212 millionaires?

Mr. OLIPHANT. The Treasury estimates that this tax will yield \$623,000,000 when passed, on the assumption that all corporate earnings are distributed.

Senator BYRD. What percent of corporate earnings is it based on, the distribution of what percent?

Mr. OLIPHANT. It does not make any difference what percent is distributed, in view of the uniformity.

Senator BYRD. I just want to call your attention to one inaccuracy about this uniformity. You just stated in your written statement that it is a fact, and yet it is not a fact.

Mr. HAAS. May I answer the Senator?

Mr. OLIPHANT. Go ahead.

Mr. HAAS. The table which Mr. McLeod was presenting at that time was the table made up not as a part of the estimate for the \$620,000,000, but some of the material in that table was used to give some measure to the committee of this tax avoidance. It was a table made up to give to the committee some measure of tax avoidance. One way to do it is to run all the earnings through the tax mill, the individual tax mill. It was made up for that purpose, to give a measure of the magnitude of this tax avoidance by withholding the earnings in the corporation.

Senator BYRD. You state then that it is purely theoretical?

Mr. HAAS. That is an illustrative table.

Senator BYRD. I thought Mr. Oliphant stated that as a fact.

Mr. OLIPHANT. I am prepared to correct myself. My reference to that table, in response to your question as to how many people there would be in that group, is a mistake and I want to correct it. I want to make this clear, that this reference, assuming all corporate earnings are distributed, made by myself and made in the Secretary's statement, and others, is a statement of a hypothetical situation for the purpose merely of bringing out the magnitude of surtax avoidance, not evasion, surtax avoidance by means of keeping corporate earnings in the corporation, and that that hypothetical statement does not enter at all into the Treasury's estimate of the \$623,000,000 produced by the bill.

Senator BYRD. What percentage of earnings were estimated to be retained by the corporation in making this \$623,000,000?

Senator CONNELLY. Let me ask you a question in connection with that. Under your theory the revenue would be just the same if they distributed every nickel of it or if they did not distribute a dime, is that so?

Mr. HAAS. Yes; that is right.

Senator KING. Mr. Haas, can you demonstrate the validity of that conclusion? Is it not on its face a complete refutation of the fact that if you distribute every cent, or distribute it all through surtaxes and through dividends, or retain a large part of it in the corporations for working capital, you get just the same tax?

Mr. HAAS. That is right. I could demonstrate that, I think, to your entire satisfaction if I had my materials here.

Senator HASTINGS. Mr. Haas, it seems to me it would be impossible to estimate. Now after these dividends are distributed the tax levied runs all the way from 4 percent to 79 percent; does it not?

Mr. HAAS. Yes.

Senator HASTINGS. It depends very largely on where they fall?

Mr. HAAS. Oh where they fall; that is right.

Senator HASTINGS. I do not know how you could possibly make that estimate.

Mr. HAAS. We do that every year on the Budget estimates. We have to estimate what the distribution of dividends will be, and our ground work, our basis for that, is the reports which we receive of income, the income-tax reports, and we tabulate them by classes. So we have, as I said before, just as satisfactory basic information for that estimate as the life-insurance company has in making up its mortality tables.

Senator KING. Well, the tax receipts would depend, would they not, on the aggregate on the amount that was paid as surtaxes and if you

distribute your dividends to a large number, say several million, who would pay no surtaxes because of the limited amount of income which they derived or an insignificant amount of surtax, obviously you would not get as much revenue as if all of the money was distributed to large holders of stocks who had large surtaxes to pay.

Mr. HAAS. You are absolutely right, but there is no reason to suspect that the income held in the corporation would go to a different group of people than the dividends which are now being paid out.

The CHAIRMAN. You took that into consideration?

Mr. HAAS. That is true.

Senator BYRD. Has the expert stated what percentage of the distribution of the earnings of all the corporations this bill was based upon, I mean, in regard to the estimate of \$620,000,000?

Mr. HAAS. Well, Senator, we have the estimate worked out so that regardless of the percent retained we get substantially the same average, whether you keep 10 percent inside of the corporation and distribute the other, the balance of it, and right on up the scale. We went over that, I think, with this committee, and also with the Ways and Means Committee, and I would be glad to bring the materials up here. I do not have them here now. I will do it tomorrow.

Senator BYRD. No matter what happens, you will get the same revenue, whether the millionaires get the dividends or whether the corporations keep them or not?

Mr. HAAS. That is right.

Senator BYRD. You spoke of \$620,000,000. As a matter of fact, the Secretary says that only \$310,000,000 will be the highest for the fiscal year 1937.

Mr. HAAS. That is right. Do you want me to explain that?

Senator BYRD. You ought to make that clear, because the Secretary said that the first year it will be only \$310,000,000.

Mr. HAAS. Mr. Oliphant explained that. Maybe you did not hear him. The estimate of \$623,000,000 is the tax liability which accrues in the calendar year 1936. That is from January 1, 1936, to December 31, of that year. That is the tax liability. Now the Budget concerns itself with when the collections of this tax liability come in. Now, the fiscal year 1937 ends 6 months after the close of the calendar year 1936, and under the regulations of the Bureau of Internal Revenue corporations and individuals are allowed to make their payments quarterly if they want to. So in the first 6 months of the year when collections begin to come in, conservatively we estimate that we will get one-half. Sometimes we get more, you see.

Senator BYRD. And it would not be until 1938 that you get the \$620,000,000?

Mr. HAAS. Yes; the full collection of that tax liability.

Senator BYRD. In the year 1938?

Mr. HAAS. That will be the full year. You are right.

Senator CONNELLY. Well, you get some of it in the fall of 1937, in installments?

Mr. HAAS. In the fall of 1937 is what we call the fiscal year 1938.

Senator CONNELLY. Not the calendar year. He is speaking of the calendar year.

Mr. HAAS. That is right.

The CHAIRMAN. Proceed, Mr. Oliphant.

Mr. OLIPHANT. For most small corporations, the amount which will be available for resubscription would be substantially larger under the proposed plan than under the present law. As a matter of fact, the proposed plan would in this respect give small corporations an advantage which they have never had before. Let me read you in this connection an excerpt from Mr. Haas' statement, which I believe covers the matter very thoroughly [reading].

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 the principal stockholders in large, prosperous, and well-established corporations. If, therefore, such principal stockholders subscribe back to the corporation for additional shares all or part of their dividend receipts, less the personal income tax thereupon, the proportion of the gross dividend receipts subscribed back by them will be much greater in the case of the average small corporation than in the case of the average large one. The great importance of the difference which exists because of the differing individual income-tax rates upon different income classes can best be seen when it is noted that while dividends which fall in the bracket between \$10,000 and \$12,000 of stockholders' individual incomes will be reduced by only a personal income tax of 11 percent, or less than the present corporation taxes, the dividends which fall in the income bracket between \$100,000 and \$150,000 will be reduced by a 62 percent individual income tax. In other words, a greater proportion of the earnings of small corporations will be available for reinvestment, when paid out to their stockholders, than of large corporations. I submit that this differential will give smaller corporations a chance to catch up upon their larger rivals which they never have had under any previous tax legislation.

Senator GERRY. Mr. Oliphant, would you mind if I interrupt you there?

Mr. OLIPHANT. By no means.

Senator GERRY. You said that there are more small stockholders in the small corporations than there are in the larger corporations.

Mr. HAAS. No; that was not the statement, Senator.

Senator GERRY. Have I got that wrong?

Senator LA FOLLETTE. The statement was that they were in the lower income group, or more likely to be.

Senator GERRY. There are more small stockholders that own two shares of stock, or a small number, in the small corporations than there are in the larger corporations? That is what I have been trying to get at. Have you any statistics that show that that is true? For example, there are a great many people who own one or two shares of stock in some very large corporations.

Mr. HAAS. You are absolutely right, Senator.

Senator GERRY. Those are the statistics I have been trying to get all through the testimony. Now, I understand there is difficulty in getting those statistics.

Mr. HAAS. The statement concerns itself with the principle, if you want to use the word, of controlling stockholders of a large corporation. The controlling stockholder of a large corporation, in general is a man of larger income than the principal stockholders of a small corporation. That is what his statement was.

Senator GERRY. I am not arguing with that, I am trying to get the other point.

Mr. HAAS. That is right.

Senator BYRD. Suppose these millionaires control a corporation and have to pay 73 percent, whereas the corporation would pay 42 percent, would they not pass it on to the surplus rather than pay that 73 percent? Will there not be tax avoidance under this bill?

Senator BLACK. Mr. Haas, they would be paying 27 percent more than under the present bill, would they not?

Mr. HAAS. The point is there probably will be some corporations of that sort, whereas, instead of having a hole so an elephant can go through we have got it at least hog-tied now.

Senator BYRD. You made the statement that certain big stockholders control a corporation and they happen to be in the million-dollar class and therefore would have to pay 73 percent. Would not they use their influence with the corporation not to declare the dividend and let the corporation pay 42 percent, thereby saving 30 percent, under your theory?

Mr. HAAS. There may be some of that.

Senator BARKLEY. There is a great difference between 15 and 42, even there.

Senator KING. Mr. Haas, do not your statistics in the Treasury Department, plus the investigations you have made indicate a gradual increasing diffusion or division of corporate stock so that there are, in the very large corporations, a large number, hundreds of thousands in some cases, of people with a small ownership, two or three or four or five shares, who of course would pay no surtax?

Mr. HAAS. Well, there is no question that many of these large corporations have stockholders who are people with small incomes, really small incomes. A person with a really small income, Senator, would probably be more likely to invest in tax-exempt securities, or will probably invest in some large corporation where it has marketability and liquidity, and so on. When Mr. Oliphant was speaking of small stockholders here, and small corporations, he had in mind, as he quoted here, incomes of \$11,000 or \$12,000 as compared with incomes in the very high brackets.

Senator CONNALLY. Well, Mr. Haas, what you said, as I understood you, was that the stockholders in the smaller corporations would be the men of smaller incomes than the ones in the big corporations that control those corporations and would not have as high an individual tax rate, and therefore a larger percentage of the net earnings in those corporations would be available for reinvestment than in the case of large corporations, because the large part of that would be taken away by the surtax.

Mr. HAAS. That is right.

Senator CONNALLY. That is what you said. Is that what you meant to convey?

Mr. HAAS. That is what I meant to convey. I meant the principal stockholders.

Senator CONNALLY. I understand.

Senator LA FOLLETTE. As a matter of fact, as I understood it, this was in answer to Mr. Ballantine's contention that 79 percent would be taken up in individual income taxes and would not therefore be available for reinvestment.

Mr. HAAS. And would affect small corporation growth.

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

Mr. OLIPHANT. I might add, in connection with the point you just made, that the bill as it now stands provides that if later one of these stockholders to whom you refer as controlling the corporation ever takes that out of the corporation he will pay the full personal-income

tax on it at that time, and it might very well be that they would hesitate a long time before embarking on that course of action.

Senator CONNALLY. Is it not true, Mr. Oliphant, that if you take two corporations with the same invested capital, the same net return, under this bill one would be taxed in one way and the other would be taxed in another way, and your theory is that on the average, in its entirety, you would get the same revenue?

Mr. OLIPHANT. That is right.

Senator CONNALLY. You are not overlooking the element of equality as between the two corporations situated exactly alike, are you?

Mr. OLIPHANT. That is right, and we have to, as I understand it, under the cases. That is, to carry this principle of equality that business profits from whatever source derived shall bear the same tax burden, to carry that out 100 percent, it would involve taxing the corporate earnings in the hands of the stockholders, whether distributed or not. That is, if you could treat all corporations as partnerships then this plan would not be subject to the limitations that you point out.

Senator CONNALLY. Corporations themselves need not be treated similarly, although they might be competing companies in the same field, is that not true?

Mr. OLIPHANT. Yes; that is true.

Senator BYRD. The Senator from Texas has brought up one of the greatest objections to this bill, that corporations competing, selling low-priced articles, pay an entirely different rate of taxes. Under this bill the taxes are going to vary from 1 percent to 42 percent. The taxes must be included in the cost of the article, with two companies competing with each other on some low-priced article, where a few cents makes a difference in the sale, and a vast difference in the payment of taxes.

Mr. OLIPHANT. That is true if they retain a different percent of earnings, but in the final analysis it will be true that the total group to which that corporation must look finally for its capital will bear the same tax load in one case as in the other case.

Senator BYRD. Mr. Oliphant, you entirely ignore the conditions that exist. One corporation has a debt now and it has got to pay 42 percent, and some other corporation competing with it will pay nothing, yet they have got to go on the market and manufacture articles and sell them on the market, having an entirely different rate of taxation.

Senator BLACK. That could be improved, could it not, as far as that goes, by doing away with the exemption for the debt-ridden corporation? That would avoid that difficulty, would it not?

Mr. OLIPHANT. That is true.

Senator BLACK. That would put them on an equality.

Senator BYRD. The Senator will pardon me, but it will not put them on an equality, because even then there will be a large variation in the taxes. They will vary from 1 percent or nothing up to 42 percent.

Senator BLACK. I mean, Senator, so far as that particular objection is concerned.

Senator BYRD. That is just one objection.

Senator BLACK. That objection would be removed by doing away with the exemption for the debt-ridden corporation.

Senator BYRD. I asked Mr. Oliphant whether or not he recommends it. He is going to furnish a memorandum tomorrow to state whether he does or not.

Senator KING. Senator Black, do you recommend a policy that will tend to destroy a small corporation that is in debt?

Senator BLACK. I do not recommend anything. I was calling attention to that provision on the ground that it produced an inequality. The individual who objects on the ground that it produces an inequality could escape it if he could have the entire paragraph stricken out.

The CHAIRMAN. We will proceed with Mr. Oliphant.

Mr. HAAS. May I make one remark, Mr. Chairman?

The CHAIRMAN. Yes.

Mr. HAAS. Senator Byrd, on this tax, which is a tax on net income, it is, after all, a cost. So your illustration, figuring out the relative cost position of the different companies, is not economically solid in this case.

Senator BYRD. He will pay the taxes on what it costs?

Mr. HAAS. No; the income taxes.

Senator KING. Let me make an observation with respect to corporations in debt. If you do not give them any exemption they are subject then to the 42.5-percent tax, so you would force liquidation immediately.

The CHAIRMAN. Proceed.

Senator COUZENS. You are at the top of page 8.

Mr. OLIPHANT. Yes, sir. So much for the proportion of earnings of small corporations which would be available for reinvestment as compared with the proportion of earnings of large corporations which would be so available. How about the mechanical facility for getting the money back? As long as a corporation is really closely held, as most small and struggling corporations are, this facility is well-nigh perfect. A year's earnings may be declared in dividends and resubscribed for stock and the whole operation completed in short order. Compare this flexibility, peculiar to the small corporation, with the more cumbersome process by which a large corporation may secure reinvestment in its business of sums disbursed as dividends, and I believe that you will agree that the facility with which small corporations may reach their earnings for additional invested capital under the proposed plan is in no way less than that which with respect to large corporations, and that, indeed, the bill insofar as it alters the situation at all, makes lighter the handicap of the small corporation in the race for supremacy.

The CHAIRMAN. Mr. Oliphant, in that connection somebody has said in connection with this matter that will be passed on by the Securities Exchange Commission. Have you any views on that?

Mr. OLIPHANT. I think that plans of this sort would be subject to that scrutiny in the case of dishonest corporations.

Senator COUZENS. They do not have to be dishonest, Mr. Oliphant, because if one corporation wanted to issue \$100,000 of stock it would cost pretty near \$50,000, and that can be wiped out by just a wave of the hand. That is a real situation.

The CHAIRMAN. Have you conversed with anyone in the Securities Exchange Commission in regard to that proposition?

Mr. OLIPHANT. Yes; the matter has been subject to general conversations.

Senator BAILEY. As a matter of fact, the Securities Exchange Commission does not pass on the validity of stock issues. The corporation is only required to file information with the Commission as to its condition, and so forth. The Securities Exchange Commission does not in any way guarantee or underwrite or sponsor it.

Senator BYRD. But it authorizes you to do it. In Virginia, the State Corporations Commission has got to pass on all the issues of stock before the stock is issued at all.

Senator KING. I think, if you will pardon the interruption, that the Securities Exchange Commission have turned down a large number of corporation applications. That ought to have made very valid the original objection. I mentioned it a moment ago. I will put in the record in a moment—I have sent for it—the fact that the number of issues during the past few years in the Securities Exchange Commission is smaller than the issues in Denmark, Sweden, Switzerland, France, or Germany. In fact, we scarcely had any issues except for refunding.

Senator BARKLEY. That means fewer people have been skinned out of their money.

Senator KING. You can take any view you please. That is an argument against the contention that you can go out and get money to invest in these corporations that are in debt. You cannot do it.

The CHAIRMAN. You may proceed, Mr. Oliphant.

Mr. OLIPHANT. Here I should like to touch, in passing, upon the corollary objection that the bill would give an advantage to corporations whose stockholders are able to resubscribe their dividends for additional stock, as compared with corporations whose stockholders are not able to do this. Note that under the present law the alternative presented is that such sum be directly invested by the corporation, and so not disbursed as dividends at all. What, may I ask, are the circumstances of stockholders who are perfectly able to forego dividends under the present law, but, if in receipt of them would be unable to resubscribe them. I submit that this inability must be merely another term for unwillingness; and I submit also that if they are unwilling to resubscribe such dividends then their judgment ought to be and must be final and that it is not the province of the Federal Government to question it. It is safer to let the real owners say when their funds shall be reinvested in a particular business.

Senator BAILEY. Do I get this from your statement, that if I was a stockholder in a small corporation and they declared to me a dividend and I do not invest it in stock because I want to support my family or keep a boy in school, that I am to be charged with unwillingness to resubscribe? It may be a case of necessity, is that not true?

Mr. OLIPHANT. That is one instance of unwillingness.

Senator BAILEY. I cannot resubscribe, I must use my money, I have got taxes to pay. All right. Here is the other fellow that is able to do it. When you sell him stock you increase your capital stock and you must give every subscriber the equal right to buy his proportionate share, but I am unable to buy. What position does that put me in? My relative holding in the company is reduced and the other man's is increased. Have you got any answer to that injustice?

Mr. HAAS. Mr. Senator, you pointed out that you received these dividends and you had some necessity or obligation to meet. What if you had not received them?

Senator BAILEY. What is that?

Mr. HAAS. Those earnings belong to you, not to the corporation. What if you had not received them, what would do about your necessity?

Senator BAILEY. I would have to go ahead, just as we have to do with a good many corporations that drew the money. I would want to use it myself. If it is there in the corporation I cannot help myself, but if it once comes out I would like to have a little liberty about using it.

Mr. HAAS. What this plan proposes is to give the owners of the corporation just the thing that you suggest, some liberty. If they want to spend it for necessities they are at liberty to spend it that way.

Senator BAILEY. How much liberty do you give a man who gets his dividends knowing that some others are going to increase their pro-rata share in the corporation? He needs his dividends. His pro-rata shares decline. How much liberty has he got under that situation?

Mr. HAAS. Well, the pro-rata, Mr. Senator, does not affect you particularly.

Senator BAILEY. The pro-rata of a man's interest in anything does affect it. If a man has one-tenth of the stock that is more important than if he only has 20 shares.

Mr. HAAS. For the purpose of control?

Senator BAILEY. Depending on how much the total is worth.

Mr. HAAS. What you are holding in the corporation is important.

Senator BAILEY. You are not going to tell me that my pro-rata holding in the corporation is immaterial?

Mr. HAAS. If you are putting it where it has control then it is very important.

Senator BAILEY. Suppose I am very far from control, it is still very important. The dividends, when they are distributed, are distributed according to the interest, and as your interest increases and mine decreases, under your operation here my pro-rata goes down and the other man's goes up. So the pro-rata is of the utmost importance. That is why we have the law requiring that when stock is sold in a corporation each stockholder shall have the pro-rata right to subscribe for his share. You would not say that that was unimportant, would you?

Mr. HAAS. You have sold some of your pro-rata shares by not resubscribing.

Senator BAILEY. I did not sell it, the other fellow bought it from the corporation. I did not get anything for it but still my interest went down.

Mr. HAAS. You had the opportunity and let it pass by.

Senator BAILEY. I let it pass by because I could not help myself. The other fellow got it back.

Mr. HAAS. The question, Mr. Senator, is not clear with me. You say you could not help yourself, but if they left it in then you could help yourself.

Senator BAILEY. I am not saying that. If they left it in it was there, I was helpless anyhow. If they distributed, then it is mine, but I have got to deal with my necessities.

Senator BARKLEY. Well, the proportionate number of shares held by one who cannot reinvest may be smaller than that held by others who do reinvest. The reinvestment made by others increases the value of the total, so the value that he holds is greater than it would be without the reinvestment of others. So he is not a loser.

Senator LA FOLLETTE. At least when it is paid out the individual stockholder has the right to decide what to do with it, instead of having the majority or minority stockholders decide for him as to what to do with it.

The CHAIRMAN. Go ahead, Mr. Oliphant.

Senator BYRD. I would like to ask Mr. Oliphant what investigation he made as to the laws of the different States that govern the sale of new stock. A large part of this goes into the distribution of dividends, and then when capital is needed for improvement, or something else, they have to sell stock. The laws in our State are very strict about it. I was just wondering whether you had gone into that fully, to see whether the small corporation you speak of, which may have had a surplus at times, whether it can sell any more stock and get the authority to sell it.

Mr. OLIPHANT. We had a great number of men examine all the statutes, the pertinent statutes in all States, and, as you point out, you will find a varying situation.

Senator BYRD. We are passing a uniform law, though, for the whole United States.

Mr. OLIPHANT. That is an embarrassment with which Congress is always confronted when it attempts to pass a law applicable to all the United States.

I might make this general observation with respect to the State Statutes. There is a broad difference, as the lawyer members of the committee will agree, I am sure, in the field of regulating corporate management, between the law on the books and the law in action, that while, in some of the States you find what on the statute books looks like pretty stiff supervision, as a matter of fact the supervision is perfunctory and largely taken care of by filing the proper papers with the secretaries of the States.

Senator BYRD. It is not perfunctory in our State. They go into it very fully. I think it is very important. Of course, if every stockholder would only receive stock in proportion to what he now owns it would not make any difference, but new stock is frequently offered to the public.

Senator CONNALLY. Is not this beside the question? That is for the States to pass on. All we are concerned with here is the tax bill. When they have got the dividends we have no jurisdiction over it. We cannot make them repay it back under the Federal law. I think you have got a controversial question that has got nothing to do with the subject matter before the committee.

Senator COZZENS. As a matter of fact, it is driving them into the temple instead of driving them out of the temple.

Senator CONNALLY. What I am trying to say is that it is no concern of ours. It is dragged in here as an argument to bolster up the bill as against the criticism.

The CHAIRMAN. Mr. Oliphant was stating it could be employed in the event they distributed their earnings.

Senator KING. May I say, in view of the statement made by the Senator from Texas, that we are concerned, even in the tax bill, with the effect which it will have upon the American citizen. If the tax bill will drive men into bankruptcy because it will prevent them from getting money for the continuation of the business, we are concerned with that, directly or indirectly, and any provision in the bill that affects business or affects the solvency of institutions for individuals, it seems to me should receive cognizance at our hands. I am sure it must receive cognizance at the hands of the gentlemen who are now drafting it.

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

Mr. OLIPHANT. Next, in our presentation before your committee and before the Ways and Means Committee of the House of Representatives, we have urged that the proposed act would result in a greater measure of equality of opportunity between the three forms of business organization, i. e., individual proprietorships, partnerships, and corporations, than exists under the present law. Under the present law very small corporations are discriminated against since their net income is taxed at an average rate of approximately 15 to 16 percent, plus the individual income surtax on the amounts of income distributed (provided the recipients thereof fall within the surtax brackets), and this rate of taxation may be greatly in excess of the rate to which the recipients would have been subject had they been operating as individual proprietors or members of partnerships. On the other hand, the present law discriminates very greatly in favor of large corporations, since it permits the undistributed portion of their income to escape, with a flat tax of about 16½ percent, while the whole of their income, were it obtained from businesses conducted as individual proprietorships or partnerships, would be subjected to much higher rates of taxation.

It has been urged that this is unrealistic since, in fact, the types of business characteristically conducted by individual proprietorships, partnerships, and corporations are quite different, and the three groups are essentially noncompetitive. It has been further urged that, insofar as they are competitive, the obvious remedy is for individual proprietorships and partnerships who do not like the discrimination to incorporate.

There is competition. For example, the chain stores are destroying our individual merchant class.

Senator BYRD. Mr. Oliphant, just at that point, are you familiar with the fact that the largest chain store in the country, the Atlantic & Pacific Tea Co., has a \$98,000,000 surplus already accumulated that will not be affected by this bill; they have \$54,000,000 of cash and call loans, and they have \$42,000,000 in Government securities, and they can perpetually evade taxes under this bill simply by distribution of earnings they made and continue the whole \$96,000,000 surplus. Yet you say they are destroying the individual merchants when the merchant must pay his tax; but the A. & P. Tea Co. will not pay any tax, and will never pay it, because they are the most liquid company of any companies that we have got. They have a surplus of \$98,000,000; they have got \$96,000,000 in cash and Government bonds.

Mr. OLIPHANT. I think the answer to that is the answer that I made a little while ago, that the total group which they represent—that is the thing we are after, is equality of tax burden—the total group which they represent will pay the tax.

Senator BYRD. Mr. Oliphant, let me go on with this. In 1934 this company earned \$20,000,000 and paid out \$16,000,000; and under this bill, if they continue that, as a matter of fact, in my judgment, they would pay all the earnings; they would only have to pay \$4,000,000 more in order to come within the complete freedom of taxation under the bill. That \$4,000,000 going to the stockholders is not going to bring in anything like as much as the company now pays. Yet you put them in a position where they will be completely free of taxation to compete with all the merchants that must pay taxes on whatever they make.

Senator BARKLEY. Is it not true that the more completely they distribute their earnings, the fewer stores they will buy up?

Senator BYRD. They have got \$96,000,000 in cash and in Government bonds.

Senator BARKLEY. That will run out sometime.

Senator BAILEY. I would like to have Mr. Oliphant explain how his plan would help the small merchant as against the Atlantic & Pacific Tea Co. Now remember the Atlantic & Pacific will have \$98,000,000 in surplus.

Senator BYRD. \$96,000,000 in cash and Government bonds.

Senator BAILEY. And no taxes to pay; but any small groceryman will have his taxes to pay, and the small corporation would have its taxes to pay. Now, how can they compete with the A. & P. Tea Co., under those circumstances? You have taken the side of the small man. I want to see how it will help the small man.

Mr. OLIPHANT. That may be boiled down to this—that his bill should have come earlier.

Senator BAILEY. Oh, well; but it did not come earlier.

Mr. OLIPHANT. It did not. I am getting now pretty far afield, but I raise the question as to the wisdom of continuing a tax system under which that condition developed, because there is still a great number of independent merchants and partnerships.

Senator BAILEY. You argued in behalf of the small merchant as against the chain store. The question then arises as to how the small merchant would stand the competition with the A. & P. T. under this legislation. We are not talking about what we should have had at the beginning of time. The question that I would like to have you answer is: How will the small man, with no surplus and a debt, paying taxes, ever be able to compete under this bill with the A. & P. T. with \$98,000,000 of surplus and an established business all over the country and no taxes to pay? Now, if you ask me that, I will be much obliged to you.

Mr. OLIPHANT. This bill does not, nor did it undertake to, remove all the inequalities that there exist.

Senator BAILEY. You agree that there is a glaring equality that you cannot explain away, do you not?

Mr. OLIPHANT. Well, I think you are asking me the question as to the wisdom of the policy of a statute which taxes existing surplus.

Senator BAILEY. No; I am asking you, since you take the side of the small merchant against the chain stores, how the small merchant would be aided against the chain store on the facts which are agreed here amongst us.

Mr. OLIPHANT. What I was trying to point out, I do not think the committee was correctly informed by the witnesses when they implied, by their statements, that there was no competition between

corporations on the one hand and individual businessmen and partnerships on the other.

Senator BYRD. Mr. Oliphant, you do not deny the statements that I now make, that if the A. & P. T. has \$98,000,000 of marketable securities and cash, and that they have a policy of paying out nearly all of the earnings, anyway, as shown by 1934, when they earned \$20,000,000 and paid out \$16,000,000, that there is no question in your mind that this company will pay out all of its earnings, resulting in little additional taxes, they will save \$3,000,000 in taxes—that is what they paid in 1934—and then compete with complete freedom of taxes with a groceryman, a corner-store groceryman, who must pay taxes to the local and Federal Government, and whatever else he has to pay?

Senator CONNALLY. And if they do pay that out they will still pay the income taxes under this bill.

Senator BYRD. No; you are relieving the corporation of the \$3,000,000 tax, because, Senator, they will distribute it.

Senator CONNALLY. You misunderstand. I say, if they pay the \$3,000,000, as they do now, we will still get the \$3,000,000, and if they distribute the balance we will get that in income taxes.

Senator BYRD. In other words, you give them \$3,000,000 more to compete with the small merchants that you say you are trying to protect.

Senator BARKLEY. We will get them from the time they begin to set aside a certain amount of surplus which results in the accumulation.

Senator BYRD. They can easily abandon the policy, because they have got \$98,000,000 in cash and Government bonds. They do not need any more.

Senator BARKLEY. That is a question.

Senator BYRD. It is the most liquid corporation on my list here, and I have a large number of them.

The CHAIRMAN. Mr. Oliphant, do you know any way of getting at these big concerns like the A. T. & T? Can you do it by law? Can you go into some of these surpluses that these gentlemen are kicking about?

Mr. OLIPHANT. Preliminary to a more general answer to that question I am bound to say I think the discussion of this question would be much more illuminating tomorrow, when we have before us these things: First, the extent to which the figures quoted correspond to the figures in the Bureau of Internal Revenue; second, what the situation is with reference to corporations lying back of these corporations, and then we may be able to judge what the conduct of the men in charge of these large corporations will be. Now, I am embarrassed because I am under that limitation, in the absence of those facts, and that I understand we will have tomorrow.

Senator BAILEY. When you get those facts we will see how a small merchant can compete, under this bill, with the A. & P. T.

Mr. OLIPHANT. To answer more generally your question I think it has to be admitted that this bill does not attempt to remove all the inequalities that there are between large and small businesses.

Senator BYRD. Does it not increase the inequality in this specific instance that I called your attention to?

Mr. OLIPHANT. I think the long-time effect of it will be the other way. Those reserves will be exhausted, and there are other reasons for accumulating reserves.

Senator BYRD. Why will they be exhausted?

Mr. OLIPHANT. In time they will be exhausted.

Senator BYRD. I say, "Why?"

Mr. OLIPHANT. Because you start with a fixed sum. The process of subtraction will exhaust it.

Senator BYRD. Unless the company loses money it will not be exhausted because they will not pay out any dividends except from what they earn. I do not think they will lose \$98,000,000.

Senator BARRELY. They will buy more stores and add them to the chain.

The CHAIRMAN. Proceed, Mr. Oliphant.

Mr. OLIPHANT. Thank you sir. Granting there is no competition, still I do not believe that these objections will stand close scrutiny. The first seems to assume that the bill aims to achieve tax equality merely between competing concerns. I challenge that. Retail merchants in New York and in California, barbers and makers of misses' dresses may hardly be said to compete, but I have yet to here it urged that they should, therefore, be subject to differential rates of taxation upon their net incomes. The fact is that our quest for equality in taxation of business income is quite independent of competition, and your committee would not for a moment listen to a proposal that net incomes derived from some occupations should be taxed at higher rates than those derived from others. Neither do believe that the gentlemen who have urged this point to your committee would favor any such proposition, if the question were put up to them squarely. But such is the inclination of all of us to justify inequities which we find already existing, that there apparently seems to be no inconsistency between suggesting a lack of competition as a justification for taxing the earnings of stockbrokers, and if I may, lawyers, at a higher rate than those of manufacturers of children's rompers.

Let me turn next to the point that any one may escape this discrimination by incorporating. The most obvious reply to this is that it is not the business of Government to compel any such thing, granting it would be socially desirable. Moreover, in many cases it simply isn't possible.

It is a remedy which is not open, for example, to the legal profession, and I believe that the lawyer members of this committee will agree with me that it will be a dark day when legislation leads to the incorporation of our law firms in order to fit them into the framework of our tax system. Neither is the device of incorporation open, for example, to members of the New York Stock Exchange.

Arguing more fundamentally, however, and independently of such special cases, are we justified in asking that people adapt the form of organization under which they do business to the single motive of minimizing taxes? The conduct of a private or investment banking business by a partnership constitutes, for example, a real gesture of good faith. It means that each partner in the enterprise is prepared to stake his whole personal fortune upon the safety of the funds entrusted to it and to the integrity of its representatives and warranties. It also means that he will be subject to income taxes ranging up to 79 percent on the incomes which he derives from the business as compared with corporation taxes aggregating only about 16½ percent on the income of his competitors who are quite satisfied with the limited liability offered by a corporation. Here the discrimination

in favor of the corporation and against the partnership constitutes nothing less than a surtax upon honor, and yet there are still partnerships of great size operating in those fields.

Senator BYRD. Mr. Oliphant, at that point, the chairman here stated—I have the greatest opinion of anything he says—that this bill was intended to put corporations on an equality with partnerships. That is the basis of it. Now, let us take a small corporation of \$10,000; it owes a debt. It has, say, three partners. Now, a \$10,000 corporation must pay that debt, must pay 29 percent. That is correct, is it not? If that money is distributed to the three partners and they have a debt, each partner getting \$3,333, after taking the exemptions off they have to pay very little.

The same thing applies to a \$50,000 corporation. If they have a debt and must pay if they have got to pay more than 29 percent, but if they have five persons and get \$10,000 each they would not pay anything like the rate the corporation would have to pay. Therefore, in my judgment, this bill does not carry out the principle of treating corporations as partnerships. The partnership has a tremendous advantage.

Mr. OLIPHANT. I think the example may be somewhat extreme, but I think it is covered by what I have said before. If you wanted fully to carry out the principle of equity, namely, that all business income from whatever sources derived shall bear the same tax burden, it will be necessary to tax business profits in the hands of stockholders, whether they are declared out or not.

Senator BYRD. Under this bill a small corporation must pay a debt, or if it reserves some of its earnings for surplus it will pay much more taxes than a partnership say of two or three or four people.

The CHAIRMAN. When you give us a response on that question you will take that into consideration.

Senator GERRY. I have another question on that.

Senator KING. May I say, I should hate to think the aim of this bill was to destroy corporations by compelling them to enter into partnerships, to apply the same yardstick as to individuals. Corporations serve a great useful purpose socially as well as economically. Legislation aimed to destroy them I do not think is right.

The CHAIRMAN. I do not think anybody connected with this bill believes that the purpose is to destroy corporations.

Senator BYRD. I do not believe that at all.

The CHAIRMAN. The Senator intimated that.

Senator BYRD. The smaller corporation pays a much higher tax under a number of conditions than a partnership would pay under exactly similar conditions.

Senator GERRY. Is it not also true that after a corporation pays this tax, if it distributes later it must pay out on the amount it distributes, while after the partnership pays the tax it pays it once and for all and can keep what is distributed to them. So there is definitely an advantage in the case of partnerships.

The CHAIRMAN. Go ahead, Mr. Oliphant.

Mr. OLIPHANT. I am coming to point no. VII. I do not believe that the answers which have been made by the witnesses of the opposition to the constructive case on this point are entitled to carry conviction. Let us look therefore, to their own constructive case—to the reasons which they advance why corporation earnings should be

taxed at lower rates than if they had accrued to individuals. These reasons, in all of the many forms in which they have recurred throughout the testimony which you have heard during the past 2 weeks, can be summed up into the general proposition that undistributed corporation earnings represent a form of savings, and that savings ought to be treated with a particular tenderness by the tax collector since they form the stuff from which our country has been built and are the only means by which its progress may continue.

There are economists who believe that under present circumstances we are suffering from oversaving rather than under-saving, but let us waive their arguments and go to the opposite extreme of granting for the moment the point made by these witnesses, that is, that corporation savings should be accorded special treatment. Do not these gentlemen prove too much? The aspect of this income which is alleged to justify such special treatment is not that it accrues to corporations but that it is designated for saving. If then, we are to accord a preferential tax treatment to funds saved by corporations, we ought equally to accord such treatment to sums saved by individuals. Are you gentlemen willing to go that far, realizing that to do so would completely vitiate the productiveness of the higher brackets of the individual income tax, and force us to raise the great bulk of the revenue for the support of the Federal Government by excises on consumption? The question answers itself.

Recurring then to the main point, if the savings of individuals are not to be accorded special tax treatment, neither should those of corporations, and I believe you will find upon reflection that most of the testimony which has been presented to you with respect to the necessity of accorded special treatment to those portions of corporation income used for expansion of plant, increase in inventory, repayment of debt, and so forth, are covered by this general principle.

BOOMS AND DEPRESSIONS

An argument upon which opponents of the proposed tax policy, Mr. Noel Sargent for example, have laid considerable stress is that it would tend to intensify both booms and depressions. This undesirable consequence is supposed to result from the effects of increased dividend disbursements in good times and reduced disbursements in bad times upon the course of the stock prices. As a matter of fact, common sense may be relied upon to establish just the contrary conclusion. The greater probability is that booms and depressions would be reduced rather than increased in severity as a result of the proposed new tax.

During the twenties the practice of reinvesting a large proportion of corporate earnings led to three notable developments. First, there occurred an excessive expansion of plant and equipment in certain industries, notably in some branches of the building industry. Second, there took place an accumulation of idle surplus funds in the hands of corporations, which reduced the purchasing power necessary to maintain a smooth flow of industrial products. Finally, there was a great increase in corporate loans to the stock market, these loans serving to augment speculation. As a concrete illustration of the accumulation of idle corporate funds during that period, we may cite the increase of \$5.6 billions between 1926 and 1929 in the cash hold-

ings of corporations reporting balance sheets to the Bureau of Internal Revenue. With respect to the financing of stock-market speculation, brokers' "loans for the account of others", representing very largely the lending of unneeded corporate reserves, increased from \$600,000,000 in 1926 to \$3,600,000,000 in 1929.

A wider distribution of corporation earnings during this period, in place of so large a volume of reinvestment of earnings, would have served to reduce the force of each of these three causes of overexpansion and speculation. Moreover, to the extent to which additional dividends were spent for consumers' goods, wholesome industrial activity would have been more amply sustained.

REGIMENTATION

Some of our witnesses lay considerable store by the charge that the proposed tax is a step in the direction of Government regulation and regimentation of business corporations. Mr. Noel Sargent in particular makes this assertion, on the ground that the tax "sets up a basic standard amount which should be retained as reserves and puts a tax penalty upon reserves beyond such arbitrary fixed standards." This argument will scarcely bear examination. The low corporate surtax rates on the first 30 to 40 percent of reinvested income permit a moderate and reasonable use of this method of raising it, to some of which I have earlier referred in some detail. In view of these various and simple methods of increasing the capital of a corporation, it is to say the least an exaggeration to claim that the proposed tax involves "regimentation" and "planning." If the bill has the effect of bringing about a greater distribution of dividends, it will have the result, not as Mr. Sargent says of "substituting Government discretion for that of management as to the amount of earnings which should be retained in the business", but of substituting the discretion of the actual owners of corporations, their stockholders, for that of their directors. So far as this might be accomplished, the effect of the bill would be democratic rather than autocratic, in the direction of a more liberal, rather than a regimented economy.

That concludes the statement.

The CHAIRMAN. Now, do any of the Senators want to ask Mr. Oliphant any questions?

Senator KING. Mr. Chairman, before we adjourn, I called attention a few moments ago to the remarkable decline in the issuance of securities by corporations in the United States since the Securities Exchange Commission and to the increase in the issue of securities in other countries. I have here the list to which I referred. I said I would put it in the record later on. I desire now the permission of the chairman and the committee to read a few sentences here and then put them in the record. This is from The Chase Economic Bulletin. [Reading:]

But even as modified by the amendments of 1934 and the intelligent rulings of the Securities and Exchange Commission, it remains unduly drastic, making responsible directors reluctant to assume the personal obligations involved in putting out new securities and especially new stock issues, so that the flow of new capital into corporations is greatly reduced. Moreover, what new capital corporations are getting in, to an undue extent, taking the form of bonds rather than stocks. The legislation on the other hand, imposes no liabilities and no regulation in the case of the United States Government, State, and municipal securities.

The following table is significant as showing how the stream of new capital to American corporations has dropped almost to a trickle, while in most other countries, despite the depression, the drop has been very much less.

Indices of new domestic corporate capital issues in different countries¹

| | United States ¹ (1923=100) | United Kingdom ² (1923=100) | Germany ³ (1923=100) | Japan ⁴ (1923=100) | Switzerland ⁵ (1923=100) | Italy ⁶ (1923=100) | Netherlands ⁷ (1923=100) |
|----------------------|--|---|------------------------------------|----------------------------------|--|----------------------------------|--|
| 1923 | 100.0 | 100.0 | | 100.0 | 100.0 | 100.0 | 100.0 |
| 1924 | 114.9 | 132.1 | 100.0 | 67.7 | 245.1 | 122.2 | 352.7 |
| 1925 | 136.7 | 195.5 | 296.6 | 88.2 | 228.5 | 225.9 | 290.6 |
| 1926 | 142.5 | 208.4 | 624.7 | 111.9 | 159.2 | 142.6 | 295.0 |
| 1927 | 176.7 | 290.0 | 635.3 | 102.8 | 169.1 | 79.4 | 229.6 |
| 1928 | 202.8 | 324.2 | 638.3 | 98.3 | 204.7 | 155.5 | 205.5 |
| 1929 | 303.6 | 235.9 | 382.2 | 70.3 | 223.2 | 182.5 | 321.7 |
| 1930 | 170.1 | 188.4 | 526.2 | 30.8 | 458.8 | 154.8 | 321.7 |
| 1931 | 58.9 | 63.0 | 340.1 | 37.6 | 500.8 | 108.8 | 67.7 |
| 1932 | 12.3 | 124.0 | 82.5 | 25.7 | 212.9 | 91.6 | 47.6 |
| 1933 | 6.1 | 140.7 | 62.0 | 76.6 | 275.2 | 84.0 | 18.9 |
| 1934 | 1.8 | 157.0 | 121.4 | 90.0 | 182.7 | 59.1 | 79.2 |
| 1935 | 12.3 | 239.0 | | 96.1 | | | |
| 1936 (first quarter) | 15.8 | | | | | | |

¹ Because of the various ways of recording data in the above countries, the indexes for the different countries are not in all respects comparable. They do, however, show the trend in each country and allowing for a small margin of error due to differences in items included in each series, the indexes may be taken as indicative of the relative movement of new issues in these countries.

Sources:

- ² Commercial & Financial Chronicle.
³ Midland Bank Monthly Review.
⁴ Statistisches Jahrbuch für Das Deutsche Reich, 1935. Figures do not include security issues by the railway company or the postal administration which function in part as private undertakings.
⁵ Economic statistics of Japan, 1934-35.
⁶ Statistisches Jahrbuch der Schweiz, 1930-34.
⁷ Banca Commerciale Italiana Movimento Economico Dell' Italia and Annuario Statistico Italiano.
⁸ Jaarlijks Verslag Nederland.
⁹ Based on first quarter of 1932.

Senator BARKLEY. That is the statement issued by the Chase National Bank?

Senator KING. By Dr. Anderson.

Senator BARKLEY. He is the statistician and economist too?

Senator KING. Yes; those are based upon the figures he obtained.

Senator BARKLEY. I would like to reserve the right to insert the appropriate section from the report of the Securities and Exchange Commission on that subject.

The CHAIRMAN. I would like to state that in the morning we have asked the Secretary of the Treasury to be here with certain data. The session tomorrow necessarily will be executive, if he gives certain facts that have been requested. It will be an executive session in the morning at 10 o'clock.

I would like to ask Mr. Oliphant and the Treasury officials in the meanwhile, if one has not already been prepared, to begin at the retention of about 30 percent of your profits and put a 15-percent tax on them, and graduate it upward, raising it upward, where they retain 50 percent and more, to get enough revenue to make \$623,000,000.

Senator BAILEY. You mean on the substitute proposition?

The CHAIRMAN. I just want to get those figures, so the committee can consider them with the others.

Senator BYRD. Is that on the basis of the substitute?

The CHAIRMAN. This is a proposition for the consideration of the committee, where we begin on a basis of 15 percent on corporation profits, and then graduate it upward, with a supertax on top of that.

Mr. OLIPHANT. You are assuming there the retention of the corporate income tax, is that it?

The CHAIRMAN. Yes; on the basis, say, of a 30-percent retention, 30 percent or under, say at 15 percent. That is about the present rate. Then graduate it upward, where they retain more than 50 percent, put it on a 60 percent basis. In other words, see if we can get \$623,000,000 on that basis. The committee can consider that in connection with this other proposal.

Senator BAILEY. Could we have some data on the subject of the substitute?

The CHAIRMAN. That substitute will bring in, as was stated before, an income of \$623,000,000, if you give a \$1,000 exemption on \$20,000 profit, and they are figuring whether or not they will go a little higher on the exemption.

Senator BYRD. Is this the substitute offered by the Treasury Department for the pending bill?

The CHAIRMAN. No; that is not a substitute particularly. You will recall that at the beginning of this hearing I requested some figures, and it is in response to that request that a more simplified form be prepared to take the place of these four schedules.

Senator BYRD. This does not necessarily have the endorsement of the Treasury Department?

The CHAIRMAN. No. That was prepared at our instance and I think this other estimate can be gotten out for your consideration in connection with this matter.

The committee will adjourn until 10 o'clock in the morning at which time we will meet in executive session.

(Whereupon, at 4:50 p. m., the committee adjourned until 10 o'clock of the following day, Wednesday, May 13, 1936.)

10A4

May 12, 1936.

H.M.Jr: Hello
Hello.

H.M.Jr: Hello - Cy?

Cy Upham: Yes.

H.M.Jr: Well how is the show going?

U: Well not very well I think.

H.M.Jr: Who is on now?

U: Herman.

H.M.Jr: Ah ha

U: He's reading his document.

H.M.Jr: Well

U: He - he made a pretty good statement very much like he did before Ways and Means --

H.M.Jr: Yes

U: but George didn't show up so very well.

HM.Jr: Did George go on too?

U: Well you see they had questions which they referred to him.

H.M.Jr: Oh yes.

U: And he - that part of it is pretty bad.

H.M.Jr: Well the questions that Herman referred to George - were they perfectly fair questions?

U: Oh I think so.

H.M.Jr: A question which George should be able to answer?

U: I think so.

H.M.Jr: And, from the ticker, it looks as though Herman was losing his temper or was he just being forceful?

U: I think just forceful with a kind of a strained note in his voice.

H.M.Jr: Ah ha.

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H: I - I don't think he's lost his temper.

H.M.Jr: Well how long do you think they'll be on?

U: Oh the course of an hour or more yet.

H.M.Jr: Ah ha.

U: Robert is here.

H.M.Jr: Good - keep your eye on him.

U: All right.

H.M.Jr: So far you wouldn't say it was going any too well.

U: No - I think it looks kind of bad for us.

H.M.Jr: Ah ha. Well will I be on publicly or an Executive tomorrow.

U: Well I think that law that you quoted to the Senator is to the effect that you can only give these - this information in Executive Session.

H.M.Jr: Yes - I just sent Harrison a letter telling him that we can 't give him the information --

U: I see

H.M.Jr: for '35. ---

U: I see.

H.M.Jr: because it's still in the field --

U: Yes.

H.M.Jr: -- and I thought - you might tell him that there is a letter on the way up.

U: All right.

H.M.Jr: An important letter.

U: All right

H.M.Jr: Most of these returns are still in the field.

H.M.Jr: And a lot of the corporations haven't made their returns yet.

U: Yes.

H.M.Jr: But - and also you might tell him, for his own confidential information, that the Internal Revenue have not come to my office yet - I'm sitting here waiting.

U: All right.

H.M.Jr: I mean just to let him it.

U: You don't have the information yet.

H.M.Jr: I mean I'm sitting here waiting and the Bureau has not yet produced any information.

U: All right I'll tell him.

H.M.Jr: And that they were not leaving - we were not leaving a stone unturned - that we had 120 people worked last night.

U: All right.

H.M.Jr: That I'm doing everything possible to comply but up to date I haven't been very successful.

U: Yes.

H.M.Jr: Don't you think he ought to know that?

U: Yes - I'll tell him.

H.M.Jr: Yes.

U: Yep.

H.M.Jr: If he has any message call me - in any event call me again in a half hour.

U: All right.

H.M.Jr: Thank you.

May 12, 1936.

My dear Mr. Chairman:

I have just received your two letters of this date relating to the following Resolution adopted by your Committee this morning:

"The Secretary of the Treasury is hereby requested to furnish a list of all corporations for the tax year 1935 that had a net income before Federal taxes of more than \$1,000,000, and based on the actual distributions for that year will receive a tax reduction under the pending bill, and

(A) The amount of such reduction for each Corporation, and

(B) The rate of taxation, if any, that would be paid by such corporation in the event the pending bill was then in effect."

You state that the information requested in this Resolution is supplemental to the request for information made by Senator Byrd in his letter of May 8th and the information requested in your communication of May 11th.

The Internal Revenue Bureau is assembling data responsive to the requests contained in Senator Byrd's letter dated May 8th and your letter of May 11th. These two letters, as you will recall, asked for the latest available data from income tax returns bearing on the lists submitted by Senator Byrd and on your inquiry as to the tax results of the full distribution of corporate income to some of the larger individual taxpayers.

When your letter of today was received examination in the light of your inquiries was being made of returns for the tax year 1934 and of such returns as were available for the tax

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year 1935. I regret that it will not be possible in view of the limited time available and in view of the fact that a large proportion of such returns as have been filed up to this time are still in the hands of field offices to give you the comprehensive data based on 1935 returns which you request.

Sincerely yours,

L. Piquet / H. Marshall Jr.

Secretary

Hon. Pat Harrison,
Chairman, Committee on Finance,
United States Senate.

FAY HARRISON, MISS., CHAIRMAN
 WILLIAM H. KING, UTAH
 WALTER F. GEORGE, GA.
 DAVID L. WALSH, MASS.
 ALBERT W. BARKLEY, KY.
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 JESSE H. METCALF, N. I.
 DANIEL O. HASTINGS, DEL.
 ARTHUR CAPPER, KANS.

United States Senate

COMMITTEE ON FINANCE

May 12, 1936

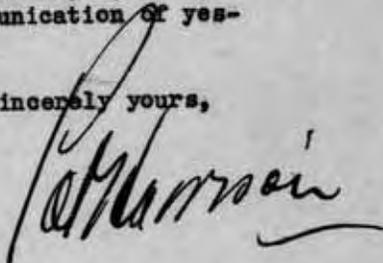
FELTON M. JOHNSTON, CLERK

Honorable Henry Morgenthau, Jr.,
 Secretary of the Treasury,
 Washington, D. C.

Dear Mr. Secretary:

Referring to my letter of today, in which I quoted the resolution adopted by the Finance Committee this morning, this is to advise you on behalf of the Committee that the information requested in this resolution is supplemental to the request for information made of you by Senator Harry F. Byrd in his letter of May 8, 1936, which was transmitted to you in my communication of yesterday, May 11, 1936.

Sincerely yours,



PAT HARRISON, MISS., CHAIRMAN
 WILLIAM H. KING, UTAH
 WALTER F. GEORGE, GA.
 DAVID I. WALSH, MASS.
 ALLEN W. BARKLEY, KY.
 TOM COVIELLY, TEX.
 THOMAS P. GORE, OKLA.
 EDWARD P. COSTIGAN, COLO.
 JOSEPH W. BAILEY, N. C.
 EDWYTT CHAMP CLARK, MO.
 HARRY FLOOD BYRD, VA.
 AUGUSTINE LOHMEYER, CONN.
 HENRY L. BLACK, ALA.
 PETER G. GERRY, R. I.
 JOSEPH F. GUFFEY, PA.

JAMES COUGENS, MICH.
 HENRY W. KEYSER, N. H.
 ROBERT M. LA FOLLETTE, JR., WIS.
 JESSE H. METCALF, R. I.
 DANIEL S. HASTINGS, DEL.
 ARTHUR CAPPER, KANS.

United States Senate

COMMITTEE ON FINANCE

May 12, 1936

FELTON H. JOHNSON, CLERK

Honorable Henry Morgenthau, Jr.,
 Secretary of the Treasury
 Washington, D. C.

Dear Mr. Secretary:

At the meeting of the Finance Committee this morning the following resolution was adopted by the Committee:

"The Secretary of the Treasury is hereby requested to furnish a list of all corporations for the tax year of 1935 that had a net income before Federal taxes of more than \$1,000,000, and based on the actual distributions for that year will receive a tax reduction under the pending bill, and

(A) The amount of such reduction for each corporation, and

(B) The rate of taxation, if any, that would be paid by such corporation in the event the pending bill was then in effect."

On behalf of the Committee, I shall appreciate if you will have this information furnished promptly.

Sincerely yours,

Pat Harrison
 Chairman

United States Senate

COMMITTEE ON FINANCE

FREE

R. H. Harrison

U. S. S.

Hon. Henry Morgenthau, Jr.,
Secretary of the Treasury,
Department of the Treasury,
Washington, D. C.

BY MESSENGER

IMPORTANT

May 12, 1936. 109

A group met in the office of the Secretary of the Treasury at 8:00 P.M. to consider certain material requested by the Senate Finance Committee for use in connection with the pending Revenue Bill.

At the outset, those present were: Mr. Morgenthau, Mr. Taylor, Mr. Bell and Mr. Upham.

In Mr. McReynold's office working on the material to be presented to the committee were: Mr. McReynolds, Mr. Gaston, Mr. Russell, Chief of the Income Tax Unit of the Internal Revenue Bureau, Mr. Oppen, Mr. Klaus and Messrs. Burns and Evans of the firm of Arthur Anderson and Company of Chicago. This group joined those in the Secretary's office later. Mr. Oliphant and Mr. Haas came in the Secretary's office for a few minutes, reported that they were feeling fine, and that they had "gotten away with murder" in their testimony on the Hill today.

The material being prepared was in response to requests from Senator Harrison including on the one hand Senator Byrd's request for data on a list of corporations which he stated, upon the authority of figures in Moody's Manual, would have paid no taxes in 1934 had the provisions of the Revenue Act of 1936, as passed by the House of Representatives, been applicable in 1934, and including on the other hand the request of Senator Black and Senator LaFollette for information with respect to personal holding companies and moneyed individuals who would have paid greater taxes had the 1934 earnings of corporations been distributed and put through the personal income tax mill.

The statement, in the form of a letter from the Secretary to

Chairman Harrison, was placed before the group, read and discussed. In conjunction with the letter a work sheet and a tabulation showing the facts with respect to the list of corporations submitted by Senator Byrd were also considered and discussed. The result of the discussion was that Secretary Morgenthau decided he would rather make an oral statement to the committee and permit Mr. Russell to present the data on the work sheet (to be rearranged and retyped) than to make any formal statement at all.

The sentiment was expressed that since all Treasury witnesses had readily admitted and emphasized that under the House plan corporations would escape tax as such if they made full distribution of their earnings, the Secretary should admit very early in any statement that he might make, that there is nothing new in the revelation by Senator Byrd that certain large corporations would have escaped tax entirely in 1934 had the pending House bill been then in force.

Mr. Upham commented that the committee had had great difficulty this morning in securing an admission from Mr. Haas that such was the case. He reported that Mr. Haas had been extremely reluctant to make a direct reply to an inquiry of that character and had insisted that it depended upon how the word corporation is defined, claiming that the word corporation, properly understood, included its stockholders.

It was agreed that the information asked for by Senator Black and Senator LaFollette would not be presented to the committee until the day after tomorrow.

Mr. Morgenthau stated very frankly to the group that if he

were asked by the committee whether or not he believed in the House bill he would say that he does not. He reiterated the position that he has been thinking for several days that he cannot be easy, as Secretary of the Treasury about giving up one billion or more of sure revenue under present law. He said, moreover, that he did not believe that small corporations had a fair chance under the bill as against large corporations which have accumulated surpluses.

Mr. Upham interjected that he did not believe it either.

Mr. Morgenthau continued he had been told by Mr. Haas that no living soul could absolutely guarantee to him that any particular amount of revenue would be received under the House bill, and, moreover, that he oughtn't to take any risk at all in the matter.

The representatives of the firm of Arthur Anderson and Company expressed their approval of the attitude taken by the Secretary and commented that he certainly saw things the same way they did and was talking "right down their alley".

Information developed with respect to the list submitted by Senator Byrd was to the effect that while most of the corporations would have paid no taxes in 1934 had they had the House bill then in force, some of them would have. There was a discrepancy in the figures presented by Senator Byrd as taken from Moody's Manual and figures collected from the income tax returns in the Bureau, probably due in large part, according to Mr. Russell to the fact that the figures in Moody's were based on a consolidation of the financial statements of

the parent corporation and its subsidiaries, while the Bureau figures were based upon a non-consolidated return of the parent corporation only.

There was a very considerable discrepancy in some cases between the "net income before taxes" submitted by Senator Byrd and the "statutory net income" figures submitted to the Bureau.

Mr. Morgenthau said that he would explain to Senator Byrd that if he wanted to make a "trick" answer and give him only the information that he asked for he could demonstrate that the Senator had made an incorrect statement to the press when he claimed that none of these companies would have paid a tax in 1934; but that he preferred to give him the whole picture.

At 11:30 the conference disbanded.

FEDERAL RESERVE BANK
OF NEW YORK

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OFFICE CORRESPONDENCE

DATE May 12, 1938.

CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION

FROM: L. W. Knode

WITH BANK OF FRANCE.

Cariguel called me at 11:45 today. There was nothing to report yesterday, he said. Consequently, he did not call. This morning had again been quiet until news reached Paris from Geneva that the Italians were leaving. As a result traders in Paris became nervous and the market upset. The better tone for francs prevailing yesterday and this morning, Cariguel ascribed almost entirely to the technical position of the market, by which he meant the covering of short positions by speculators. The lower sterling rate this morning (the price dropped to \$4.96 1/4 abroad before our opening), Cariguel thought, was due greatly to Swiss operations. The Swiss rate having in terms of dollars and French francs dropped to the lower gold point, the Swiss National Bank decided to take advantage of the high gold price in London, sold gold there and supported the Swiss rate by means of sterling sales. The fact that the number of bars sold in the London gold market (272) was unusually large, seems to bear out Cariguel's argument. I inquired whether, in his opinion, yesterday's vote on the Frazier-Lemke Bill had made much of an impression on the markets there. Cariguel replied that as far as he was concerned he had not even had time to follow it. I made reference to the request of the French bankers committee to refrain from future exchange transactions, etc. Cariguel seemed to feel that this request was likely to be effective in curbing forward transactions, which had assumed very large proportions.

LWK:EMC

OFFICE CORRESPONDENCE

DATE May 11, 1936.

CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION

FROM: L. W. Knoke

WITH BANK OF FRANCE.

I called Mr. Cariguel at 3 p. m. yesterday afternoon. Blum had not spoken yet, Cariguel said, but the general feeling seemed to be that he and the other leaders were inclined to be moderate. Nevertheless, their hand might be forced by their followers. The main difficulty the new crowd was facing was that it had made too many promises and might now be called upon to deliver the goods.

With reference to Saturday's market, Cariguel said, it had been pretty heavy; the British Fund's operations had been slightly in excess of 160,000,000 francs. Next week, he thought, would be heavy. I timidly inquired how long he thought this could go on and he replied that that depended entirely upon the government. He agreed with me that restoration of confidence was the essential thing. As a matter of fact, he thought it was the only thing that was now needed to get them out of the woods because the other remaining stumbling block, namely, the difference in price levels, had now been adjusted. I referred to the very disturbing effect the communistic declarations about a levy on capital have had. Cariguel replied that from personal friends who had close contact with the Extreme Left Wing political parties, he had gained the impression that there was no intention among the Socialists to ask for such capital levy. He continued that Russia might curb any such tendencies, not out of pure love for France, but simply because she did not want France to be in trouble just now. In other words, for Russia, it was nothing but a question of self-interest.

Cariguel promised to call me today.

LWK:KMC

May 12, 1936.

Ambassador Sze, Mr. Chen, Mr. Taylor and Mr. Lochhead met with the Secretary today. The Chinese presented a draft of announcement to be made concerning the results of their conferences with the United States Treasury. (Copy of the draft is attached.)

HM, Jr. proceeded to read aloud from the draft. When he had finished reading paragraph No. 1, Mr. Taylor referred to the expression "monetary value". He said to the Ambassador, "Remember we had several discussions about that, Mr. Sze, and suggestion was made that you would start off by covering the value of the old yuan and I am just wondering if that word "monetary" in there might not be confusing. Just eliminate that word entirely."

Mr. Chen: Yes.

Mr. Taylor: Then you can say at that time, where we start off, you will use the old yuan.

HM, Jr.: Put a line through monetary.

Mr. Chen: This is draft. We can go over that in our sub-committee afterwards.

HM, Jr.: Anything else?

Mr. Taylor: No.

HM, Jr. read paragraph No. 2 aloud.

Mr. Chen: Government issue silver of one-half yuan and one yuan.

HM, Jr.: You don't say in this anything about the fineness.

Mr. Chen: The fineness we have agreed.

Mr. Taylor: It is not necessary to mention it.

HM, Jr. read the third paragraph aloud.

Mr. Sze: That is the restriction.

HM, Jr.: Fine.

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HM, Jr. began to read paragraph No. 4. When he came to the words "grant a credit for United States of America dollar twenty million," he said, "Let's just take that."

Mr. Lochhead: My personal opinion is they should not put anything concrete in that. I don't see why you should make anything public or explicit. If you say anything, say arrangements have been made.

HM, Jr.: Arrangements have been made for the sale of silver. I think that's better.

Mr. Chen: Yes.

Mr. Sze: Without saying so many ounces.

HM, Jr.: I think "for the sale of silver." I think that's better. Why should they know how big the pot is?

Mr. Chen: Yes. Leave that open.

HM, Jr. We have agreed, but not for public announcement. It gives them something to shoot at.

Mr. Taylor: I think you should word it to say that "proceeds of the sale"; say that "proceeds of the credit" should be used for exchange stabilization.

HM, Jr.: That has to be fixed up.

Mr. Chen: Yes.

HM, Jr.: I think that sentence could be improved, if you don't mind my saying so.

Mr. Chen: Yes. Yes.

Mr. Lochhead: I think we ought to talk that over. I don't think -- of course, it's a question of how much you want to say there at all. I would rather say that some arrangements have been made to insure the stability -- or to help them in maintaining exchange.

HM, Jr.: Yes, something like that.

Mr. Lochhead: What it really is, is assistance in stabilizing.

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HM, Jr.: What I want to put in there -- we are really exchanging yuans for dollars -- say something about arrangements for supplying them dollar exchange.

Mr. Lochhead: Arrangements also have been made for supplying them with dollar exchange against the yuan, or simply supplyind dollar exchange?

HM, Jr.: I am thinking out loud. I don't know the technical language. I would say, "arrangements have been made to supply the Chinese Government with dollar exchange against Chinese earmarked silver on deposit in the Federal Reserve Bank in San Francisco."

Mr. Lochhead: That sets it up as a loan. That is just a silver loan.

HM, Jr.: Have you any suggestions?

Mr. Sze: I have a suggestion to make. When this came in, I submit to you for your reaction. Personally, we put much faith in that. From political point of view, Kung will say he is not negotiating a loan. If you say credit, it causes misunderstanding. Personally I am not under any preference. I suggest, "Arrangements can also be made whereby Federal Reserve Bank of New York will grant facilities to the Central Bank of China in matters of foreign exchange."

Mr. Lochhead: Of course, it is not the Federal Reserve Bank.

HM, Jr.: I would say that agents of the Treasury have been instructed to furnish the Chinese Government with dollar exchange? Maybe you will want to say the Federal Reserve Bank acting as fiscal agent of the Treasury, or you can simply say our fiscal agencies have been instructed to furnish the Chinese Government with dollar exchange.

Mr. Taylor: I think from their standpoint it would be better to name the Federal Reserve as fiscal agent.

HM, Jr.: Then say, "The Federal Reserve, acting as fiscal agent for the United States Treasury, has been instructed to furnish the Chinese Government."

Mr. Taylor: The Central Bank of China.

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Mr. Chen: Yes. Yes.

Mr. Lochhead: Referring back to the beginning of the announcement (reading) "Minister of Finance takes pleasure in announcing that as a result of recent conversation, etc.". Don't you think that should be, instead, the Chinese Ministry of Finance and the American Treasury?

HM, Jr.: I am acting here and not the State Department because it is a monetary matter. I would say "the United States Treasury and the Minister of Finance," because otherwise if it is the United States Government, then you have to go over and see the State Department.

(HM, Jr. then read aloud paragraph No. 5.)

HM, Jr.: It is all right. It is very good.

Mr. Chen: Maybe you wish to add something from your point of view.

HM, Jr.: I would say something at the end here that the Minister of Finance of China and the United States Treasury feel that the financial mission headed by Mr. Chen, through the exchange of information, has led to a much closer and sympathetic understanding of the monetary problems of both nations.

Mr. Chen: Yes. Yes.

Mr. Sze: Yes.

Mr. Chen: Also add prestige of the mission come over!

HM, Jr.: That's what I have in mind, Mr. Chen. Something like that.

* Mr. Chen: I wish to say to you today, in a more or less personal way, to explain my position. When I was first sent over here by Dr. Kung, the object of the mission was to sell a large amount of silver to the United States.

HM, Jr.: How much did they want you to sell?

Mr. Chen: Two hundred million ounces. But after I had

* From here to asterisk in about center of following page, remarks of Mr. Chen and HM, Jr. are not verbatim, but were dictated by Mr. Lochhead.

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had a chance to talk to the Treasury officials, I realized that this plan was not practical nor desirable. As a result of our many conversations we drew up a memorandum on the increased use of silver which was laid before you and accepted by Dr. Kung. In drawing up this memorandum, I estimated that 75,000,000 ounces would be the minimum amount necessary to insure the success of the program and if I am not successful in carrying out my program and in fact only arrange for the sale of 50,000,000 ounces as against the 200,000,000 ounces which Dr. Kung had in mind, it may seem to the people in China that I have not been completely successful. I am not a politician, but merely a business man and when I go back to China it is going to be necessary for me and Mr. Koo to work hard to insure the success of this program. If I can go back and state that the United States Treasury has agreed to my plan and is willing to help carry out the details as suggested by me, the purchase of 75,000,000 ounces would greatly strengthen my hand in seeing that the necessary reforms are made.

HM, Jr.: I appreciate your position, but I am not prepared to make a definite answer right at this moment. Do not press me at this time, but I assure you that I will give it very careful consideration and let you know the outcome. *

I think we are moving very fast now.

Mr. Chen: Yes.

HM, Jr.: I am under no particular pressure, except the newspaper men keep asking me and I say we are getting along fine.

Mr. Sze: I noticed your quote in the Wall Street Journal.

HM, Jr.: Did you? What did I say?

Mr. Sze: You said you have your foot on the bottom of the throttle.

HM, Jr.: Oh, yes. I said once before that our negotiations were accelerating, so they asked this week how things were moving. You know, when you are riding and you accelerate the engine, you put your foot on the gas, so I said we have our foot on the bottom of the throttle. These things are

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very important and I would rather take two weeks more and have them right.

Mr. Chen: We want them to be right.

HM, Jr.: You let me think that over, Mr. Chen, and give it very serious consideration.

DRAFT ANNOUNCEMENT

Minister of Finance takes pleasure in announcing that as a result of recent conversation held at Washington, D.C., Chinese and American Governments have arrived at an accord concerning currency matter of common interest.

In order to strengthen the position of the Chinese currency and to increase the use of silver the Government had adopted the following measures:

1. It will be the policy of the Government at all times to maintain adequate reserves consisting of gold, foreign exchange and silver, the silver portion of the reserves to have a monetary value equivalent to at least 25% of the note circulation;
2. For the purpose of completing the reform of the Chinese coinage system, the Government will issue fiduciary silver coins of ^{half yuan} ~~fifty cent~~ and one ^{yuan} ~~dollar~~ denominations;
3. The restriction governing the use of silver in the manufacture of silver articles, as contained in the regulation promulgated November 15, 1935, will be removed;
4. For the purpose of strengthening the position of the Chinese currency and providing funds to be used exclusively for maintaining the exchange value thereof, arrangements have been made for the sale of ~~ounces~~ ^{ounces} of silver. And arrangement also has been made whereby the Federal Reserve Bank of New York, on the security of silver, will be prepared to grant a credit for United States of America dollar twenty million to be used exclusively for exchange stabilization.

Minister

Minister expressed great satisfaction at these arrangements which he stated will assure the stability of the Chinese currency and its maintenance as an independent system not linked to any foreign monetary unit.

Draft of our Press Release5/15/36
Press Release
1-39

The representatives of the Chinese Ministry of Finance who have been in the United States to make some studies of our monetary and banking system, and to exchange views on monetary problems of mutual interest, have completed their mission and are returning to China.

Our conversations with them have been mutually instructive. I feel confident that the monetary program being pursued by the National Government of China is not only along sound lines, but constitutes an important step toward the desired goal of stability of world currencies.

To supplement their efforts toward that objective and to cooperate with them in their program of monetary reform and currency stabilization, and in accordance with our silver purchase policy, we have definitely indicated our willingness, under conditions mutually acceptable, to make purchases from the Central Bank of China of substantial amounts of silver, and also to make available to the Central Bank of China, under conditions which safeguard the interests of both countries, dollar exchange for currency stabilization purposes.

The mission headed by Mr. Chen has been instrumental in bringing about a more complete understanding of our mutual monetary problems.

I believe that only through full and frank exchange of views similar to that which has just taken place between the representatives of the Chinese Ministry of Finance and ourselves will it be possible to improve the internal stability of national currencies and with this achieve a greater international stability.

The Minister of Finance takes pleasure in announcing that in the light of experience and of additional knowledge of monetary conditions obtained in China and abroad, the Chinese Government deems it desirable to adopt the following measures of monetary reform to supplement those embodied in the decree of November 3, 1935:

1. It will be the policy of the Government at all times to maintain adequate reserves against note issue consisting of gold, foreign exchange and silver, the silver portion of the reserves to have a value equivalent to at least 25% of the note circulation;

2. For the purpose of completing the reform of the Chinese coinage system, the Government will issue silver coins of fifty cent and one dollar denominations;

3. The restriction governing the use of silver in the manufacture of silver articles, as contained in the regulation promulgated November 15, 1935, will be removed;

4. For the purpose of further strengthening the position of the Chinese currency, definite arrangements have been made to increase the gold and foreign exchange portion of the note issue reserve.

The minister expresses the firm belief that these supplementary measures of monetary reform and the arrangements made will assure the continued maintenance of an independent currency system not linked to any foreign monetary unit and the permanent stability of the Chinese currency which will inevitably lead to greater economic improvement and prosperity of the Chinese people.

5/15/36

Draft of our Press Release

Minister of Finance

The representatives of the Chinese ~~Treasury~~ ~~Ministry~~ who have been in the United States to make some studies of our monetary and banking system, and to exchange views on monetary problems of mutual interest, have completed their mission and are returning to China.

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W. H. C. -
I believe that only through full and frank exchange of views similar to that which has just taken place between the representatives of the Chinese Minister of Finance and ourselves will it be possible to achieve stabilization of world currencies

improve the internal stability of national currencies and with this a greater international stability

TREASURY DEPARTMENT

124 A

Washington

FOR IMMEDIATE RELEASE
MONDAY, May 18, 1936 .

Press Service
No. 7 - 39

STATEMENT BY SECRETARY MORGENTHAU

The representatives of the Chinese Ministry of Finance who have been in the United States to make some studies of our monetary and banking system, and to exchange views on monetary problems of mutual interest, have completed their mission and are returning to China.

Our conversations with them have been mutually instructive. I feel confident that the monetary program being pursued by the National Government of China is not only along sound lines, but constitutes an important step toward the desired goal of stability of world currencies.

To supplement their efforts toward that objective and to cooperate with them in their program of monetary reform and currency stabilization, and in accordance with our silver purchase policy, we have definitely indicated our willingness, under conditions mutually acceptable, to make purchases from the Central Bank of China of substantial amounts of silver, and also to make available to the Central Bank of China, under conditions which safeguard the interests of both countries, dollar exchange for currency stabilization purposes.

The mission headed by Mr. Chen has been instrumental in bringing about a more complete understanding of our mutual monetary problems.

I believe that only through full and frank exchange of views similar to that which has just taken place between the representatives of the Chinese Ministry of Finance and ourselves will it be possible to improve the internal stability of national currencies and with this achieve a greater international stability.

May 14, 1936.

Memorandum for SECRETARY MORGENTHAU:

As a conclusion of the conferences with the Chinese, the following steps are contemplated:

Meeting at your house tonight, at which you will tell the Chinese your judgment as to the amounts of silver to be purchased on the following steps which will be taken:

Steps to be taken by the Chinese Minister of Finance:

1. Announcement on Monday in accordance with the enclosed press release.
2. Letter to Secretary of the Treasury describing in detail the steps covered in the public announcements and their import.

Steps to be taken by the Secretary of the Treasury:

1. Statement to the press after the Chinese statement has appeared in Nanking (copy attached).
2. Acknowledgment of letter from Minister Hung enclosing copies of letters of instructions to the Federal Reserve Bank of New York, one letter to cover purchase of _____ ounces of silver, and one letter to establish terms on which up to \$20,000,000 of dollar exchange will be made available to the Central Bank of China.

May 12, 1936

I said to the President today that the Canadian liquor situation is an entirely different proposition than the German problem. If the Attorney General says that we are right legally on countervailing duties, then all the arguments from Hull about trade for Germany does not hold water. I asked, "Is that right, Mr. President?" and he answered, "Yes, that is right."

May 12, 1936

When HM, Jr. returned from the White House, where he had attended a tea given for the Chinese, he sent for Graves and Taylor. He said, "I saw the President and told him that the liquor companies combined have offered us a settlement of about \$3,000,000. The President said that normally he would say that if they offered us 3 million and we are asking 6 or 7 million he would want one-half of the difference between 3 million and 6 million or 4½ million. On account of the "good neighbor" policy he will start between zero and what the Treasury wants and split that in half. In other words, if the Treasury wanted 6 million, the President said, "I am going to insist on 3 and you can tell Mr. Phillips that if we do not get that I will explain personally to the country what is back of the whole thing." Graves told HM, Jr. that we can take 3 million. HM, Jr. said, "The President wants this transmitted to the Canadians tonight and we must have an answer by 3 o'clock tomorrow."

HM, Jr. then called Mr. Phillips on the telephone and said, "I talked to the President about this Canadian liquor situation and I told him that in the back of our minds we wanted 6 or 7 million from the Canadians and that, roughly, they have offered us about 2½ millions!" (Actually the figures were as follows:

| <u>NAME OF COMPANY</u> | <u>ACCEPTABLE OFFERS</u> | <u>OFFERS MADE</u> | <u>FINAL OFFERS</u> |
|------------------------|--------------------------|--------------------|---------------------|
| Seagram's | \$3,000,000 | \$1,200,000 | \$1,500,000 |
| Walker | 2,000,000 | 800,000 | 1,000,000 |
| United | 500,000 | 225,000 | 243,750 |
| Consolidated | 500,000 | 237,500 | 256,250 |
| | <u>\$8,000,000</u> | <u>\$2,462,500</u> | <u>\$3,000,000</u> |

Continuing the conversation with Mr. Phillips, the Secretary told him, "The President said, 'I wish you would call Phillips and tell him that he should tell the Canadian Government tonight that normally I would ask between what he wanted and what they offered, but on account of our friendship for Canada he will take half between zero and what we wanted, in other words, \$3,000,000.' Graves tells me that we did have an offer of \$3,000,000, but I do not think the President knew that. Tell them that that is his last word; that if they do not accept it the President would have to explain the whole thing to the country. We will give them up to 3 o'clock tomorrow to give us an answer. Graves says the Canadian Government has ordered the companies to pay us \$3,000,000. I wish you would let Graves explain this thing to you. He is going into his own

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room and his extension number is 398. Will you call him in a few minutes?"

Washington, D. C.,
May 12, 1936.

Honorable Hume Wrong,
Canadian Embassy,
Washington, D. C.

Dear Sir:

As a result of arrangements made between the United States Government and the Canadian Government, I have had the opportunity of meeting representatives of the Department of Justice and the Treasury Department, who in the course of such conferences, presented claims on behalf of the United States Government against the Seagram Companies, their subsidiaries and affiliates, shareholders, directors, officers and employees thereof, and against firms, persons and companies (including officers and employees) that purchased and sold products of the Seagram Companies.

My clients are firm in their belief that they are under no legal or moral obligation in respect of the said claims and that they have never violated either in letter or spirit any American laws.

They being, however, desirous of maintaining cordial relations with the various departments of the American Government in view of their extensive investments and operations in the United States, and being also naturally desirous of avoiding long and expensive litigation; and particularly because of what I believe to be the desire of the respective governments that the matter should be amicably determined, and giving regard further to certain pending legislation and governmental action, I made an offer on behalf of my clients to the representatives of the Treasury Department and the Department of Justice which I considered adequate, but which they did not deem acceptable.

In order to accomplish the desirable results above indicated and having regard to the various discussions recently had, and without prejudice to the position of my clients, I desire to offer in full and final settlement of all demands and claims of whatever kind asserted by the United States Government against the companies, represented by me, and the interests and individuals associated with them, the sum of \$1,500,000.00, payable as follows:

\$250,000.00 in cash upon execution and delivery of the necessary instruments of settlement and release, satisfactory to counsel; and

\$1,250,000.00 payable at the rate of 30 cents per gallon to be paid concurrently with the importation into the United States of Seagrams whiskies presently in Canada, with the definite agreement that the total of said settlement balance will be paid not later than December 31, 1937, with the right to prepay in whole, or in part, if so desired by my clients before the final due date.

I shall be obliged if you will be kind enough to convey this offer through the proper channels.

I have the honor, Sir, to be,

Respectfully yours,

LAZARUS PHILLIPS

COPY

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HIRAM WALKER & SONS, LIMITED.
Walkerville, Ontario, Canada.

May 12, 1936.

Hume Wrong, Esq.,
Canadian Legation,
Massachusetts, Ave.,
Washington, D. C.

Dear Sir:

Re: Hiram Walker & Sons Limited
Gooderham & Worts Limited (Canada).

I refer to the long distance telephone conversations had with you yesterday by Mr. Lash and myself.

Mr. Lash advised you that the amount of the offer set out in his letter to the Honourable Sam E. Whitaker of May 7th last, would be varied, and that you might inform the representatives of the United States Government such offer would be to pay the United States Government, on the terms and conditions set out in Mr. Lash's letter, the sum of Two Hundred Thousand Dollars, (\$200,000) in cash; together with a further amount of Eight Hundred Thousand Dollars, (\$800,000) payable at the rate of twenty cents (20¢) per U.S. proof gallon of whiskey exported to the United States at time of export.

I now write formally to confirm such offer.

Yours very truly,

(Sgd.) W. J. Hume,

President.

Approved on behalf of Gooderham & Worts, Limited

(Sgd.) W. J. Hume, Chairman of the Board.

CANADIAN LEGATION

WASHINGTON

May 13th, 1936.

My dear Mr. Phillips:

In accordance with your request, I am writing to confirm my statement to you that representatives of certain Canadian distilling companies against which claims have been advanced by the Government of the United States have informed me of their readiness to settle these claims on terms involving in the total the payment of \$3,000,000. The situation with respect to each of the companies is as follows:

1. Distillers Corporation - Seagrams.

I attach a copy of a letter addressed to me today by Mr. L. Phillips on behalf of these companies, offering to make payment in the method described of the amount of \$1,500,000.

2. Hiram Walkers - Gooderham & Worts.

A written offer of settlement for \$800,000 on behalf of these companies is already on file at the Department of Justice. I attach a copy of a letter addressed to me on May 12th by Mr. W. J. Hume, President of Hiram Walker & Sons, Limited, increasing the previous offer to \$1,000,000.

3. Consolidated Distilleries.

A written offer to pay \$237,500 on behalf of this company and associated companies has already been made by Mr. L. A. Forsyth. I have received today a telegram from Mr. Forsyth, stating that he is prepared to increase this offer to the sum of \$256,250.

4. United Distillers.

A verbal offer of the payment of \$200,000 has already been made to representatives of the Treasury and Justice Departments by Mr. C. H. Locke on behalf of this company and associated companies. Mr. Locke has today telegraphed to me that he is prepared to increase this offer to the sum of \$218,750. He also informs me that a written offer of \$25,000 in settlement of the claim against Coast Breweries has been made to the Treasury Department.

-2-

I understand that counsel for the companies are prepared to confer with representatives of the Government of the United States with regard to the formal acceptance of these offers and the issue of releases in respect of the claims.

Believe me, my dear Mr. Phillips,

Yours most sincerely,

H. WRONG

Chargé d'Affaires.

The Hon. William Phillips,
Under-Secretary of State of the United States,
Washington, D. C.

May 12, 1936

In connection with the O'Connor-Crowley matter, there is included in the diary, under this date, a report of the group meeting held to discuss the pending tax bill. Included in that report is the Secretary's remarks to those present concerning Jesse Jones' request that the Treasury not make a written report on the O'Connor-Crowley controversy and McIntyre's remarks to the Secretary at the White House that O'Connor had called him, McIntyre, to insist upon a written report. Also a reference to Carter Glass and Bert Wheeler's remarks.

M E M O R A N D U M

On the afternoon of May 14th, 1936, Secretary Morgenthau, Jesse Jones, Marvin McIntyre and Mr. McReynolds met in the Cabinet Room to discuss the Leo T. Crowley matter. Messrs. Jones and McIntyre objected to Mr. McReynolds and his committee extending the study they had undertaken beyond the report made by National Bank Examiner Brown, which had previously been placed in their possession. Messrs. Jones and McIntyre objected to any original investigation being made or any further conferences being held with Mr. Crowley; making it very clear that it was their desire that the McReynolds' committee confine their activities to stating, in as brief form as possible, what was disclosed by the Brown report.

The Secretary pointed out that since Mr. Crowley had requested a copy of the Brown report and any analysis made of it for the purpose of enabling him to make specific reply to any criticism contained therein, it was his feeling that no action should be taken and no conclusions reached until Mr. Crowley had been given the opportunity to prepare any reply he desired to make. It was agreed, however, that the next step would be the completion of the brief requested of the McReynolds' committee and any action thereafter would be decided on later.

McR:gmc

May 13th

Paul Weiner came in to see Mr. Morgenthau this afternoon in regard to the position which the State Department offered him in connection with the International Art Exhibit in Paris. H. M. Jr. told Mr. Weiner that he ought to accept the offer "without pay" but that it would be a mistake to accept a salary for his services. The post they are offering him is Assistant to the Commissioner.

May 13, 1936.

Hon. Pat Harrison,
Chairman, Committee on Finance,
United States Senate,
Washington, D. C.

My dear Mr. Chairman:

I am glad to advise you that the Government has been able to effect a settlement of its tax claims against the Canadian distilling companies which would be affected by the provisions of section 402 of H. R. 9185, the so-called Liquor Tax Administration Bill. The Department accordingly desires to withdraw its request for the inclusion of this section in the bill.

Yours very truly,

(Signed) H. Morgenthau, Jr.
Secretary.

HNG/mff

May 13, 1936.

Hon. William H. King,
United States Senate,
Washington, D. C.

My dear Senators:

I am glad to advise you that the Government has been able to effect a settlement of its tax claims against the Canadian distilling companies which would be affected by the provisions of section 402 of H. R. 9185, the so-called Liquor Tax Administration Bill. The Department accordingly desires to withdraw its request for the inclusion of this section in the bill.

Yours very truly,

(Signed) H. Morgenthau, Jr.

Secretary.

HMG/mff

MAY 11, 1936

PAT HARRISON, MISS., CHAIRMAN
 WILLIAM H. KING, UTAH
 WALTER F. GEORGE, GA.
 DAVID I. WALSH, MASS.
 ALLEN W. BARKLEY, KY.
 TOM CONNALLY, TEX.
 THOMAS P. GORE, OHIO
 EDWARD P. CUSTER, COLO.
 ISAIAH W. BAILEY, N. C.
 BENNETT CLAMP CLARK, MD.
 HARRY FLOOD WYRD, VA.
 AUGUSTINE LONGRAN, OHIO
 MISSO L. BLACK, ALA.
 PETER B. GERRY, N. I.
 JOSEPH F. DUFFY, PA.

JAMES COVENS, MICH.
 HENRY W. KEYS, N. H.
 ROBERT M. LA FOLLETTE, JR., WIS.
 JESSE H. METCALF, R. I.
 DANIEL O. HASTINGS, DEL.
 ARTHUR CAPPER, KANS.

United States Senate

COMMITTEE ON FINANCE

May 13, 1936

FELTON M. JOHNSON, CLERK

Honorable Henry Morgenthau, Jr.,
Secretary of the Treasury,
Washington, D. C.

Dear Mr. Secretary:

At the executive session meeting of the Finance Committee this morning the Committee authorized me to request of you the following information:

A list has been submitted by the Treasury Department giving certain data as to corporations with net incomes of a million dollars or over who will receive a fifty percent reduction in tax under the pending tax bill. It is requested that similar data be furnished the Committee with respect to corporations with net incomes of a million dollars or over whose taxes will be increased by the pending bill.

It is requested that data be furnished similar to that furnished the Committee this morning in executive session, with respect to corporations which have practically paid no dividends, including the surplus of such corporations. Also, if possible, please furnish the names of the large individual shareholders, including corporate shareholders.

It is requested that data be furnished as far as possible relative to the directors of some of the corporations, whose personal income taxes will be increased under the pending bill even though the corporate tax may be decreased.

The requests for information contained in this letter are supplementary to the data which was requested in my communication of May 11, 1936.

Sincerely yours,

May 13, 1936

McReynolds, Taylor and Gaston met with the Secretary.

HM, Jr. told Mr. McReynolds that George Haas said they will have the estimate out for Harrison on the Harrison plan. McReynolds replied, "Yes, they already have that, but it does not produce enough revenue and they had to modify it and that is in process. On the Connolly plan, the figures will be done tonight. And those are the two tax estimates that are in the mill and, incidentally, everything is here that was asked for. Then, on the other stuff, Charley and Guy were in and the most of it is ready. Do you have a new letter from Pat?" and HM, Jr. replied, "Yes."

The Secretary asked Mr. McReynolds if he had held a meeting in his office at two o'clock and McReynolds said yes. "Everyone was there on the job and everything went very well and everybody has his little stunt to do and we are perfectly happy about it." HM, Jr. asked, "Don't you think I had better come back tonight; otherwise, I will not be familiar with it." When HM, Jr. answered "Yes" in response to Mr. McReynolds' inquiry as to whether the Secretary would be before the Committee before, McReynolds said, "Then I will see that the material is brought in." HM, Jr. said, "I will be here at 9 o'clock tonight." McReynolds said, "You won't want to look at the tax estimates," but HM, Jr. said, "Yes, I do. I want to be familiar with everything. As a matter of fact, I don't want anything to go to this Committee that I don't first see."

The Secretary then read the letter just received from Pat Harrison:

"At the executive session meeting of the Finance Committee this morning the Committee authorized me to request of you the following information:

A list has been submitted by the Treasury Department giving certain data as to corporations with net incomes of a million dollars or over who will receive a fifty percent reduction in tax under the pending tax bill. It is requested that similar data be furnished the Committee with respect to corporations with net incomes of a million dollars or over whose taxes will be increased by the pending bill.

It is requested that data be furnished similar to that furnished the Committee this morning in executive session,

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"with respect to corporations which have practically paid no dividends, including the surplus of such corporations. Also, if possible, please furnish the names of the large individual shareholders, including corporate shareholders.

It is requested that data be furnished as far as possible relative to the directors of some of the corporations, whose personal income taxes will be increased under the pending bill even though the corporate tax may be decreased.

The requests for information contained in this letter are supplementary to the data which was requested in my communication of May 11, 1936."

McReynolds told the Secretary, "There are two things in there that they are not working on -- the last two and they won't be ready." HM, Jr. then instructed him, "Get as much as possible." The Secretary then wanted to know if they had picked any one corporation and McReynolds said they had picked twenty. HM, Jr. inquired, "Is Du Pont among them? Make a note. I want it to be, at the confidential request of Senator Hastings who whispered in my ear that he suggested I take the Du Pont Company. Now, you figure that out! Senator Hastings!"

HM, Jr. then inquired, "What about our two Chicago accountants? What's happened to them?" McReynolds answered, "The boys have been sort of milling around on this stuff. They have been trying to get things done. The Chicago men have been more or less with Seltzer. He spent the morning with them. The other man, Dr. Viner is working with him. (This is Mr. Himmelblau.) HM, Jr. inquired, "Are they happy? Should I talk to them or should I stay away from them?" and McReynolds answered, "I don't know. Of course, they would be happier if Haas had the time to sit down and go over that estimate base with them, but he just does not." HM, Jr. asked McReynolds if he could leave that with him and McReynolds replied, "Yes, I will be glad to take them on."

The Secretary told the men he has an appointment at 4:30 and at 5 Doughton is coming in, "And that's a political matter. I will come back at 9. Taylor, you need not come back, but everybody who is working on this thing, I would like to have them. It isn't necessary for you, Gaston, to come back." And Gaston answered, "I don't know whether I want to come down or not." HM, Jr. asked, "You are tired? You need not come back. But I do think Oliphant, Haas, Helvering, and Russell should be here and McReynolds. I don't need Bell tonight." And McReynolds agreed.

Retention of all present corporation taxes with graduated tax on undistributed adjusted net income superimposed

1. Rate schedule.

a. Present graduated corporation income tax, corporate stock, and excess-profits taxes.

b. On the undistributed adjusted net income, bracket rates as follows:

No tax on the first 20 percent of adjusted net income retained;
20 percent on the next 10 percent of adjusted net income retained;
30 percent on the next 10 percent of adjusted net income retained;
45 percent on the next 10 percent of adjusted net income retained;
50 percent on all of the income retained in excess of 50 percent of the adjusted net income.

2. Corporations treated in a special manner, such as those in bankruptcy and those having contracts not to pay dividends, those with debts, etc., would be treated in the same manner as under the bill passed by the House. The amount of income to be subject to such special rates would be deducted from the adjusted net income together with the tax thereon, to determine the adjusted net income which would be subject to the regular rates on the amount undistributed.

3. Corporations with adjusted net incomes of less than \$20,000 would be subject to lower effective taxes on their undistributed adjusted net income in the following manner: after computing the tax in the usual way on the undistributed net income, such corporations would be subject to only such percentage of the computed tax as the percentage which their adjusted net income is of \$20,000.

4. Preliminary estimated yield (in millions of dollars):

| | | |
|--|--------------|-------|
| Statutory net income | \$7,200 | |
| Corporation income tax | <u>964</u> | \$964 |
| Statutory net income less tax | \$6,236 | |
| 90 percent of intercorporate dividends | <u>1,000</u> | |
| Adjusted net income | \$7,236 | |

*original to Secy by Mr Hoos at meeting in Secly's office 5/13
copy to Miss Chauncey 5/13*

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| | |
|--|--------------|
| Brought forward | \$964 |
| First 20 percent retained, \$1,447, no tax | 0 |
| Next 10 percent retained, \$724, at 20 percent | 146 |
| Next 10 percent retained, \$724, at 30 percent | 217 |
| Next 10 percent retained, \$724, at 45 percent | 325 |
| Capital stock and excess-profits taxes | <u>168</u> |
| Total | \$1,819 |
| Less present corporation taxes | <u>1,132</u> |
| | \$ 687 |
| Deduct loss on relief to small corporations | <u>47</u> |
| Net increase in revenue | \$ 640 |

Note: No loss in revenue because of the special provisions for certain debt corporations, etc., has been estimated, but the amount of such loss would be the same under this proposal as it is under the House bill.

Federal Tax Collections Estimated in the Budget
Message of January 3, 1936

(In millions of dollars)

| | <u>Fiscal year 1936</u> | <u>Fiscal year 1937</u> |
|--|---------------------------------|---------------------------------|
| Current corporation income taxes <u>1/</u> | 615 | 826.6 |
| Capital stock tax | 92 | 163 |
| Excess profits tax | <u>10</u> | <u>5</u> |
| Total | 717 | 994.6 |

Federal Tax Collections accruing in the
Calendar year 1936

(In millions of dollars)

| | |
|--|----------|
| Current Corporation income taxes <u>1/</u> | 964 |
| Capital stock tax | 163 |
| Excess profits tax | <u>5</u> |
| Total | 1,132 |

1/ Does not include back taxes.

May 14, 1938

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Upham telephoned the following:

The following is being typed and sent you by letter from Senator Harrison, but Senator Harrison wanted you to have it by 'phone first.

The Senate Finance Committee this morning adopted the following resolution:

The Secretary of the Treasury is hereby requested to furnish a list of all corporations for the tax year of 1935 that had a net income before Federal taxes of more than \$1,000,000, and based on the actual distributions for that year will receive a tax reduction under the pending bill, and (a) the amount of such reduction for each corporation, and (b) the rate of taxation, if any, that would be paid by such corporation in the event the pending bill was then in effect.

Upham also stated that Senator Byrd indicated that this was asking for a little more information than he had previously requested.

United States Senate

COMMITTEE ON FINANCE

May 14, 1936

File

PAT HARRISON, MISS., CHAIRMAN
 JAMES COZZENS, MICH.
 HENRY W. KEYES, N. H.
 ROBERT M. LA FOLLETTE, JR., WIS.
 JESSE H. MEYCALP, R. I.
 DANIEL O. HASTINGS, DEL.
 ARTHUR CAPPER, KANS.
 JAMES H. HIND, UTAH
 JOHN P. BROWN, GA.
 ED L. WALSH, MASS.
 W. H. BARKLEY, KY.
 JOHN CONNALLY, TEX.
 THOMAS P. GORE, OKLA.
 EDWARD P. COSTIGAN, CALIF.
 EDWIN W. BAILEY, N. C.
 ROBERT CHAMP CLARK, MO.
 HENRY FLOOD BYRD, VA.
 CHRISTINE LINDENBAUM, CONN.
 THOMAS L. BLACK, ALA.
 GEORGE S. DENNY, R. I.
 JOSEPH P. GUFFEY, PA.

FELTON N. JOHNSTON, CLERK

Honorable Henry Morgenthau, Jr.,
 Secretary of the Treasury,
 Washington, D. C.

Dear Mr. Secretary:

At the executive session meeting of the Finance Committee this morning the Committee authorized me to request of you the following information:

Data as to corporations showing a tax reduction under the pending tax bill, comprising the system of which the companies placed in the record by Senator Byrd this morning are a part, that is, the interlocking companies.

Information has been furnished the Committee with respect to corporations whose statutory net income is in excess of \$1,000,000 and who distributed practically no dividends. This list should be enlarged to cover corporations whose net income plus dividends received from other corporations is in excess of \$1,000,000. From the data submitted, information is desired as to those companies which are classified as public utilities.

The information submitted this morning with respect to shareholders of corporations for the year 1932 should be submitted also with respect to the year 1934. Tax computations should also be made under both the Revenue Act of 1932 and the Revenue Act of 1934 so that they may be compared with the existing rates under the Revenue Act of 1935.

Information is requested as to the loss of revenue from the pending tax bill over existing law in the case of the two hundred or so companies placed in the record by Senator Byrd this morning. Information is also requested as to the loss of revenue under the pending tax bill over existing law in the case of the companies listed and furnished to the Committee in executive session on yesterday, May 13, 1936.

Sincerely yours,

Pat Harrison

May 14, 1936

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Tax Proposal of Senator Connally

I. Tax Provisions

1. Impose 15 percent tax on statutory net income.
2. Define adjusted net income as the statutory net income less corporation income taxes plus 90 percent of intercorporate dividends received. Define undistributed net income as adjusted net income less the dividend credit. Impose a tax on undistributed net income equal to the sum of the following:
 - 10 percent of the amount of the undistributed net income which is in excess of 20 percent and not in excess of 40 percent of the adjusted net income.
 - 13 percent of the amount of the undistributed net income which is in excess of 40 percent and not in excess of 60 percent of the adjusted net income.
 - 16 percent of the amount of the undistributed net income which is in excess of 60 percent and not in excess of 80 percent of the adjusted net income.
 - 20 percent of the amount of the undistributed net income which is in excess of 80 percent of the adjusted net income.
3. Remove exemption of dividends from individual normal tax.

II. Estimated Revenue, Calendar Year 1936

Estimated increase in revenue over present law \$499 millions

If, in addition to the dividend credit, a special credit of \$1,000 is given all corporations with adjusted net income of less than \$20,000, the estimated increase in revenue will be reduced by \$14 millions.

Note: These estimates make no allowances for any changes in the law which have been proposed other than those indicated above.

Tax Proposal of Senator Harrison - No. 2

I. Tax Provisions

1. Impose 15 percent tax on statutory net income.
2. Define adjusted net income as the statutory net income less corporation income taxes plus 90 percent of intercorporate dividends received. Define undistributed net income as adjusted net income less the dividend credit, and, in the case of corporations with adjusted net income of less than \$20,000, a special credit of \$1,000. Impose a tax on undistributed net income equal to the sum of the following:
 - 2 percent of the amount of the undistributed net income which is in excess of 30 percent and not in excess of 35 percent of the adjusted net income.
 - 5 percent of the amount of the undistributed net income which is in excess of 35 percent and not in excess of 40 percent of the adjusted net income.
 - 10 percent of the amount of the undistributed net income which is in excess of 40 percent and not in excess of 45 percent of the adjusted net income.
 - 20 percent of the amount of the undistributed net income which is in excess of 45 percent and not in excess of 50 percent of the adjusted net income.
 - 30 percent of the amount of the undistributed net income which is in excess of 50 percent and not in excess of 60 percent of the adjusted net income.
 - 45 percent of the amount of the undistributed net income which is in excess of 60 percent of the adjusted net income.

II. Estimated Revenue, Calendar Year 1936

| | : Dividends exempt : from normal tax : on individuals | : Dividends subject : to normal tax : on individuals |
|--|---|--|
| (in millions of dollars) | | |
| Estimated increase in revenue over present law | 302 | 409 |
| Reduction due to special credit given small corporations | <u>32</u> | <u>32</u> |
| Estimated net increase in revenue | 270 | 377 |

Note: These estimates make no allowances for any changes in the law which have been proposed other than those indicated above.

Tax Proposal of Senator Harrison - No. 1

I. Tax Provisions

1. Impose 15 percent tax on statutory net income.
2. Define adjusted net income as the statutory net income less corporation income taxes plus 90 percent of intercorporate dividends received. Define undistributed net income as adjusted net income less the dividend credit, and, in the case of corporations with adjusted net income of less than \$20,000, a special credit of \$1,000. Impose a tax on undistributed net income equal to the sum of the following:
 - 30 percent of the amount of the undistributed net income which is in excess of 30 percent and not in excess of 40 percent of the adjusted net income.
 - 35 percent of the amount of the undistributed net income which is in excess of 40 percent and not in excess of 50 percent of the adjusted net income.
 - 45 percent of the amount of the undistributed net income which is in excess of 50 percent of the adjusted net income.

II. Estimated Revenue, Calendar Year 1936

| | : Dividends exempt : from normal tax : on individuals | : Dividends subject : to normal tax : on individuals |
|--|---|--|
| (in millions of dollars) | | |
| Estimated increase in revenue over present law | 517 | 661 |
| Reduction due to special credit given small corporations | <u>35</u> | <u>35</u> |
| Estimated net increase in revenue | 482 | 626 |

Note: These estimates make no allowances for any changes in the law which have been proposed other than those indicated above.

THE FUNDAMENTAL BASIS OF THE TAX BILL

Getting All Additional Permanent Revenue
Needed by Stopping Bur-tax Avoidance.

Our approach to that problem (putting the Budget picture back in order) was this: Let us frame the tax measure so that the burden of the tax will fall in that area and upon that portion of the population where it will create the minimum of hardship. That brings you at once to this question. After all, taxes have to be paid by individuals. Then all is said, taxes come out of the pockets of individuals.

From what sources can individuals pay taxes? Except for minor items, there are only four. They can get funds with which to pay taxes from business profits; they can get those funds in the form of receipts from rents; they can get them from interests and they can get them from wages and salaries. There are no other possibilities, if you exclude minor items such as royalties and things of that sort.

The problem then is, from which of these four sources from which people can pay taxes should the major part of this new money required be taken in order to produce a minimum of hardship upon the population, the people as a whole. What do the figures show?

They show, first, that people's receipts from interest are going down with the falling interest rates in this period of easy money into which we have entered. They show, second, that the taxpayers' receipts from rents are but slightly up; they are up but only slightly. They have just begun to recover.

And they show, third, that people's receipts from salaries -- and

we can disregard wages largely, because most income tax payments out of wages and salaries come out of salaries rather than out of wages — that such increase as we have had in business profits, to which I shall allude in a moment, has not yet had time to get itself reflected in a corresponding increase in people's salaries. As we emerge from this depression there has been, as on emergence from all previous depressions, a lag between an increase in the business profits and an increase in the salaries paid out of those business profits.

That leaves the fourth item, business profits, and on that it is gratifying to note how substantial the increase in business profits is. This is in no sense an attack on business profits. We welcome it, because increased business profits means increased business activity and that means increased employment; and increase of employment, I dare say, is the problem that lies nearest to the heart of every man in this room if he adjourns all other considerations except considerations for the public good.

That are the dimensions of the increase in business profits? Reliable figures from impartial sources show that corporate profits during 1935 were 42 percent above those in 1934. They show also, one of the most reliable indexes reflecting profits of corporations, that during the third quarter of 1935, business profits were 69 percent above business profits during the third quarter of 1934. They show that in the fourth quarter of 1935, the increase over the corresponding period in 1934 was 117 percent. Figures for the first quarter of 1936 are not available. Preliminary estimates indicate a substantial increase, not as great as the last increase that I mentioned.

So that if the additional tax burden is to fall in that area where the increased burden which the Congress is called upon to lay will produce the least hardship, the major part of the increased revenue must come from business profits, in the absence of any corresponding increase in the three other sources from which people can pay their taxes.

So we in the Bureau and in the Treasury, seeing what the dimensions of the increase in business profits was, turned to the next problem. Upon what part of that field, *i. e.*, upon what portion of all of the people of the country receiving the increased business profits, should the major portion of the additional burden be placed if we are to produce the minimum of hardship?

Business profits are received by three groups of people; by the owners of individual businesses, by partners, and ultimately by the stockholders of corporations. There are a total, according to the last census figures available, of 450,000 corporations in this country. There are a total of individual businessmen and individual partnerships of 1 1/2 million, to use round figures. The gross sales or production of corporations comprising the whole national figure for this year, 1935, was 142 billion, and gross sales or production of the individual enterprises and partnerships was 50 billion.

The first thing occurring to us, and to anybody else approaching the problem in the same way, was the fact that those engaged as individual businessmen and as partners are bearing the full tax load of our graduated surtaxes. Are those receiving business income from corporations doing so? The answer to that question, which surprised the Treasury when they found it,

to my mind, makes no other form of taxation at this juncture possible of defense.

On our estimates -- and past performance shows their dependability -- if corporate profits during the year 1936, all of them, went out to the stockholders and passed through the personal income-tax will as opposed to part of them being paid in the form of a corporation tax, the total of that is the figure you have had of over \$4,000,000,000. That is, if those profits all went to stockholder and we applied our present graduated surtax rates to them, they would produce enough additional revenue to provide for the permanent needs of the Government at this time, over 680 millions of dollars.

So that is where we wound up. We found: increase in business profits with no corresponding increase in rents, salaries or interests; business profits coming from individual enterprises or partnerships now paying the full income tax load, and enough corporate profits not carrying the full surtax load which if made to do so, would provide a total of 680 millions of dollars, stated by the President to be required at this juncture.

May 14, 1936

HM, Jr. called the President this morning.

He said, "I am going up on the Hill again this morning. I was at the Treasury last night until 11 o'clock. This going into Executive session and then letting Harry Byrd do all the talking to the press is terrible. Hearst's man, Hutchinson, is feeding all this stuff to Harry Byrd.

"In talking to Key Pittman, last night, I found that he is entirely satisfied with the Chinese silver agreement. He made one suggestion and that is to take out of the memo the word 'stabilization'.

"I asked Pittman how he felt about removing the tax on silver. You see, no domestic manufacturer can buy silver here. He has to go abroad for it. I want to remove this criticism. Pittman is for it.

"I would like to get an extension now of the Stabilization Fund for two years. The European Powers are talking that our stabilization fund is going to run out in February and they are going to capitalize on it. It shows a weakness on our part. I want to go up and ask Jack Garner to have the leaders in his room so that I can talk to them. If they can guarantee it 100%, O.K.; otherwise, I will forget it for this session.

"Everything is very quiet in France. There is an outstanding nervousness in England on account of this Italian move. Otherwise, things seem to be quiet."

May 14, 1938

Just before lunch, I called up McIntyre and told him I could not take Sam Hill as Assistant General Counsel as he is a sick man; that we would take Truitt as Assistant General Counsel, and my recommendation was to put Hill on the Board of Tax Appeals. Doughton came in here at noon and I told him how I felt and he agreed with me. He said that Hill did not want to go in as Assistant General Counsel in Internal Revenue; that it was the President's idea.

Then the President called me on the telephone and again urged me to take Hill. I pleaded with him very, very strongly not to make me take him. I told him that there were no scandals in Internal Revenue up to date, but I just could not gamble at this time on Hill and that there were too many of my people, including myself, who are on the verge of a breakdown. I said, 'Please put Hill on the Board of Tax Appeals.' I told the President that Doughton was sitting right next to me and the President said, 'Wait a minute; I will send for Forster and see if there is a vacancy for a Democrat'. The President returned to the telephone in a few seconds and said, 'Yes, there is. I will put Sam Hill on the Board of Tax Appeals,' and I said, 'I promise you that we will take Truitt in as Assistant General Counsel in the Treasury.' He said, 'Fine!' and I thanked him very much. The President seemed under a great strain. Doughton was tickled pink and said, 'This is fine! This is what Sam Hill really wanted and this idea of putting Hill into Internal Revenue was the President's idea and not what Hill wanted at all.'

McIntyre then called me back on the 'phone again and jokingly said, 'There is a delegation from Cincinnati that is going to call on Herman Oliphant in regard to putting Stephen Foster's face on a memorial coin. Tell Oliphant to be sympathetic,' and I said, 'Mac, if you can clean up this Sam Hill business, I will put the Democratic donkey on the memorial coin, and he said, 'That is O.K. with me, as long as you don't put Zioncheck on the coin,' and I said, 'I will put Mrs. Zioncheck on the coin.'

I spoke to McIntyre a third time and said, 'I promised Farley that nobody would go on the Board of Tax Appeals until he, Farley, returned, and I wanted to tell him that,' and McIntyre said, 'Let Farley worry!', to which I replied, 'Have I cleared myself with you?' and he said, 'You have.'

May 15, 1936

THE TAX SITUATION ANALYZED

A. The basis of the President's Message:

It had two objectives; (1) equalizing taxes on business profits; and (2) getting permanent revenue needed merely by stopping surtax avoidance.

1. Repealing present corporate taxes and subjecting dividends to normal tax would accomplish the first objective. This could be postponed without injury to the second objective.
2. Imposing rates on undistributed earnings equivalent to the average personal income tax rates will attain the second objective. No lesser rates will.

B. Present situation in Senate Committee:

The underlying situation in this Committee now is that the opposition members are pinned down under two facts and are squirming and fighting but can't get out from under these facts. They are caught in this vice: one jaw is that the country now knows that all the new permanent revenue needed can be got by stopping surtax avoidance and that it can be stopped; The other jaw is that only rates on undistributed earnings as high as the House rates will stop it.

C. The moral:

If we keep pouring on the facts on surtax avoidance by named men and companies, the result will be one of two things:

1. Either the Committee will accept the House rates or their equivalent; or
2. A full investigation of surtax evasion will be voted and raising of part of the \$620,000,000 will go over until January.

TREASURY DEPARTMENT

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INTER OFFICE COMMUNICATION

DATE May 15, 1936

TO Secretary Morgenthau
FROM Mr. Taylor

Subject: Substance of conference of the Chinese representatives - Ambassador Sze, Messrs. Chen, Kuo, and Koo - with Treasury representatives - Secretary Morgenthau, Messrs. Taylor, Lochhead, Oppen, and White - 8:30 P.M., May 14, 1936, at the Secretary's home.

1. Secretary Hull's approval.

Before the Chinese representatives arrived the Secretary got in touch with Secretary Hull over the telephone and told him that the negotiations were coming to a close, and inquired whether the State Department had any question they wished to raise before final statement was made to the Chinese representatives. The Secretary also explained to Secretary Hull that Mr. Taylor had been in touch with various members of the State Department, including Mr. Phillips and Mr. Hornbeck, that afternoon and had been informed that so far as they knew everything was all right with them and, further, if Mr. Taylor did not hear from the State Department before that evening he was to know that everything was clear with the State Department. Mr. Hull stated over the 'phone that it was all clear with him and he heartily congratulated Secretary Morgenthau on the splendid success of his negotiations. Secretary Morgenthau humorously suggested that Secretary Hull reserve his congratulations until after Labor Day and see whether events justified them.

2. Amount and monthly rate the Treasury proposes to bid on.

The Secretary informed representatives of the Chinese Government that the President and he were desirous of having the Chinese representatives return home contented with the results of their mission, so that they would be better able to stimulate co-operation at home in the execution of China's monetary program. The Secretary informed them that the President and he had agreed the total amount of silver the Treasury is willing to purchase is 75 million ounces.

The Secretary made it perfectly clear to the Chinese representatives that the purchases of silver were to be pro-rated on a monthly basis and that the amounts were to be non-cumulative. If the Central Bank of

China did not take advantage of the Treasury's bid to the full amount during any one month, the difference between the full amount of the monthly quota and the amount they did sell was not to be added to the quotas of the subsequent months.

The Chinese representatives all definitely indicated their complete understanding and acquiescence to the arrangement.

3. Duration of purchase arrangement.

The Secretary said there was some question whether the period during which the purchases are to be made should be 8 months (which would bring the close of the period on January 15th) or 12 months (which would bring the close of the period on May 15th). He requested the views of the Chinese representatives. Mr. Chen stated he preferred the 8-month arrangement to the 12-month, but that he was perfectly agreeable to abide by the wishes of the Secretary in that matter. The other Chinese representatives likewise indicated their preference for the 8-month period. The Secretary stated that he would take the matter up with the President and that he would inform Mr. Chen on the following day whether it was to be an 8-month or a 12-month period.

4. Chinese press release.

A draft of the press release to be issued by the Minister of Finance in Nanking was read and approved. It was stated by the Secretary that it was his understanding the press release was to be probably issued in Nanking on Monday morning, May 18th. Mr. Chen agreed.

5. Treasury press release.

A draft of the press release to be issued in Washington by the Secretary was then read and some alterations made at the suggestion of the Chinese representatives also had some suggestions to offer with regard to the phraseology of the press statement to be released by the Secretary. Their suggestions were, on the whole, incorporated with some modifications.

There was also discussed for a brief period the merits of including the following sentence suggested by the Secretary:

"I believe that only through full and frank exchange of views similar to that which has just taken place between the representatives of the Chinese Minister of Finance and ourselves will it be possible to achieve stabilization of world currencies."

Secretary Morgenthau - 5/15/36, 3.

The Secretary requested Mr. Chen's opinion on the suggested sentence and Mr. Chen said it would be a good thing for his country if the sentence were added. Further discussion on this sentence was postponed until the departure of the Chinese representatives.

6. Upon leaving, the Chinese representatives expressed their unqualified and enthusiastic approval and appreciation of the proposals made by the Secretary and with the results of their mission here.

7. After the departure of the Chinese representatives, the sentence referred to above was carefully reconsidered. The Secretary finally stated that he would get the President's opinion as to whether or not the sentence should be included, and if so what changes, if any, should be made in it.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE May 15, 1936.

TO Secretary Morgenthau

FROM Mr. Taylor

Subject: Substance of conference of the Chinese representatives - Mr. Chen, Mr. Kuo, and Mr. Koo - with Treasury representatives - Mr. Taylor, Mr. Lochhead, and Mr. White; 12:00 noon, May 15, 1936.

1. Monthly quotas of silver shipments.

The Chinese representatives were informed that it was arranged the amounts of silver which the United States Government would bid on were to be 12 million ounces during the month ending June 15th, and 9 million ounces during each month thereafter until January 15, 1937. Mr. Chen said he was completely satisfied with that arrangement.

Mr. Lochhead explained that it was desirable to postpone shipping silver for sale here until after June 1st, though shipments of silver to be held here as collateral could begin earlier. He also made clear to Mr. Koo that to avoid the possible payment of a tax it would be desirable for the Central Bank of China not to ship any silver for sale until it was sold to the United States.

2. China's press release.

Mr. Chen stated that a copy of the press release to be made by China would be cabled to Mr. Kung at once, with the understanding that it would probably appear in the press in Nanking or Shanghai Monday morning, May 18th. It was emphasized by Mr. Taylor that it was understood there was to be no change in the wording of the public announcement. If Mr. Kung wished to make some alteration, it would be necessary to cable back the change and the whole matter would have to be gone over here again.

3. Treasury press release.

It was explained to the Chinese that the Treasury press release would be made after the appearance of the Chinese statement in the press in China.

There was some brief discussion as to the advisability of cabling Mr. Kung a copy of the proposed press release of the Treasury. To

Secretary Morgenthau - 5/15/36, 2.

prevent possible leaks, however, the Chinese representatives decided to cable neither the statement, nor a digest of it, but merely to refer to it as being quite satisfactory.

4. No specific sums of silver sales or credits to be mentioned in the public statement.

Mr. Taylor stated that he did not think the Secretary would mention any specific amounts involved in the silver and credit transactions. Mr. Taylor suggested that it would probably be desirable for the authorities in China likewise not to divulge the specific amounts.

5. Draft of paragraphs for letter to the Secretary.

A copy of the suggested draft of paragraphs to be included in the letter to be sent by Finance Minister Kung to Secretary Morgenthau was turned over to Mr. Koo. Mr. Chen stated the draft would be cabled at once and would be accompanied by the request that Mr. Kung cable his opinion of the draft before sending a completed copy of the letter to be submitted to the Secretary. It was clearly understood by the Chinese representatives that the letter was to be a confidential one.

May 18, 1936

The following were present at the 9:30 tax meeting: McReynolds, Upham, Bell, Helvering, Russell, Haas, Kent, Seltzer, Turney, Taylor, Gaston and Oliphant.

The Secretary addressed the group, as follows: "When I see the President at lunch today, I want to give him an analysis of the Harrison plan boiled down to bed-rock -- where it differs from the House bill; what things are left out of the House bill, such as intercorporate dividends, etc. and, if we can agree, where we think the Harrison plan is so far away from what the President wants that we think it is a mistake. Everything I say in this room is absolutely confidential.

"The position the last time the President talked to Harrison and Doughton was that they want to go a flat 15% plus a sliding scale on super-graduated tax. At that time we decided that we would gracefully give it to them." Oliphant interrupted and said, "Reluctantly and gracefully."

At this point Helvering came in and Mr. Morgenthau repeated to him what he had told the group.

Continuing his remarks to the group, the Secretary said, "In talking to the President, this morning, I said something about an 18% tax and he immediately said it must be graduated. I want the analysis so that I can talk to him about it at noon."

(Seltzer, Turney and Kent were on the Hill Saturday.) Speaking directly to Kent, the Secretary asked him, "How would you say the situation is and what are they expecting from the Treasury this morning?" Kent replied, "The only thing they inquired for were the final estimates on the Harrison plan." HM, Jr. then asked, "In other words, they are waiting for Seltzer who is expected this morning at ten o'clock?" Turning to Seltzer he said, "You had better go up right away and take the necessary people with you." Russell and Turney were assigned to go with Seltzer. The Secretary told Seltzer and Turney that he knew that they did very well on the Hill on Saturday.

HM, Jr. then told the group that Upham took the so-called Eccles memorandum up on the Hill without his knowledge. He said, "I am telling you about it because I do not want Oliphant or Haas to think that I am sending up memoranda on the Hill. I do not know whether you, Upham, want to add anything to what

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I have said?" Upham did not wish to comment. Continuing, the Secretary said, "I am not sending any memoranda on the Hill and I have explained to Upham not to take any memorandum whatever to the Hill. I have sent him up just to observe as a reporter what is going on during the day and not to take part in the discussion one way or the other. I just want to make it perfectly clear so that our own family will understand."

Oliphant discussed the various points which he will incorporate in the analysis which he will give to the Secretary to take to the White House. (Copy of the analysis is attached to report of meeting at White House today at 2:15 pm.)

HM, Jr. arranged with McIntyre that Helvering and Oliphant would meet him at the White House at 1:145 to discuss the tax bill with the President.

Just before the close of the meeting, the Secretary told the group, "I think, in this room, we might as well give up the idea that we will get the bill as it passed in the House. Oliphant put it very well: we will have to "reluctantly and gracefully" recede."

In talking to McIntyre on the 'phone, Mr. McIntyre called off the 11 o'clock appointment at the White House because Jesse Jones was in Chicago. Mr. McIntyre asked the Secretary to see Mr. O'Connor at 11 o'clock in HM, Jr.'s office.

HM, Jr. asked Taylor and Gaston to remain after the meeting. He discussed with them the idea of inviting Chen, Koo and Kuo to the press conference this afternoon and also Ambassador Sze. He told them that the Chinese will probably want to give out a statement and that he will read to the press his statement. (Copy of the Treasury announcement is attached.) HM, Jr. said he also wanted photographers and movie men in if they thought it was important enough to come.

May 18, 1936

Upham called up and said that things went very well on the Hill this morning and that the Committee has asked for several more estimates on other plans; that they have recessed until Wednesday morning when the Treasury said they would have the estimates ready, and that the so-called Harrison plan is changing from hour to hour; that Harrison has not committed himself to the plan which appeared in the paper; that what he is trying to do is to get an agreement of the Committee by Wednesday on a plan.

Notes on Meeting at White House May 18, 1936, 2:15-2:50 pm.

Present:

President Roosevelt
Secretary Morgenthau
Herman Oliphant
Guy T. Helvering
George C. Haas

Secretary Morgenthau handed President Roosevelt a statement entitled "Status of Tax Bill", copy of which is attached. The President began by reading the statement. After reading about half of the first page, he stopped to comment that he had a hunch we were going to win this tax case yet. After reading the full statement, The President asked as to where we should go from here.

Mr. Oliphant then explained the tax situation as it existed in the Senate Finance Committee, and the difficulties the Committee was encountering in getting a majority of the members to agree on the House bill, or on any other proposal. Mr. Oliphant went on to report that at this morning's session of the Committee so many members of the Committee were making proposals and asking for estimates that Senator LaFollette remarked that if we were going to have an amateur day on the tax program we might adopt the plan used by the radio companies of having trial auditions first.

The President at this point again stopped to consider what would be the best strategy. He indicated, without coming to a conclusion, that it might be well to let them fuss around for a while. The President then picked up the memorandum and said there were three important points in the statement, and he wrote the following:

1. The Senate proposal places the burden of the new revenue on 2,700,000 people, operating much as a sales tax, as compared with the House bill which affects less than 60,000 people not now carrying their due share of the tax burden on that portion of their real incomes represented by withheld corporate profits.

2. The House bill provides the additional revenue required by merely stopping the tax leaks, that is the prevention of surtax avoidance.

3. The Senate proposal hits small corporations and all partnerships and individual businessmen, the reverse of the House bill.

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The President then raised the question as to the best method of getting this information to the public. Secretary Morgenthau said he thought it was too early to use yet as he felt we did not see the whites of the eyes of the Senate Finance Committee. The President then suggested another plan of strategy, which he outlined as follows: that he call Senator Harrison in this evening and, in a manner of giving him a tip, outline these three fundamental objections to his proposal and indicate to him the political dynamite, etc., involved in his tax plan. The President thought that such a meeting would also serve the purpose of giving Senator Harrison some encouragement and support. Secretary Morgenthau agreed with the President that this was an excellent line of procedure.

In discussing the matter further, The President said that even if it were impossible to get a majority committee report, that he felt the fight could probably be won on the floor of the Senate.

The President considered briefly the question of Mr. Doughton's reaction to any changes the Senate might make in the bill, and concluded that probably not much difficulty would be encountered on this score inasmuch as the Senate's simplification of the complicated House schedules is really an improvement in the House bill.

Mr. Oliphant, commenting further on the possibility of a fight on the floor of the Senate, told the President that Senator Black was going to ask that the Senate have access to the confidential information which the Treasury presented to the committee on tax avoidance by people with large incomes. The President seemed very pleased with the fact that such information was available but wondered if it would not be better if some one other than Senator Black were to handle the matter on the floor. Senator LaFollette's name was suggested but after further reflection The President said that after all probably the best man to handle it on the floor would be Senator Barkley.

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*Account on
Henry Jones
National Bank
New York*

*May 18th 1936 - White House
2.15.P.M. 167*

STATUS OF TAX BILL

*Haas - H.O.
Guy - Helvering*

I. Summary of the Harrison Plan and of its Results

A. The items in the Harrison plan (they will be enumerated and in each case the corresponding recommendation of the President's message will be stated):

1. Retain corporation income tax and raise it to 18% flat. *wants graduation*
The President's message recommended repealing this and the other two corporate taxes.
2. Levy a flat 7% tax on undistributed earnings regardless of size of corporate income and of percent of earnings retained. The President's message in substance recommended a tax on undistributed earnings equivalent to personal income normal and surtaxes, with no corporate tax if full distribution.
3. The plan would place the normal tax on dividends after raising it 25%. The message recommended its imposition without increase.
4. The plan would increase the normal tax on everybody from 4 to 5% whatever the source of their income. The message recommended no increase in the personal income tax rates.
5. The plan would make retentions of earnings under 30% presumably reasonable and retentions in excess of 50% unreasonable; and subject unreasonable retentions to the higher tax rates of Section 102. The message did not mention this method of handling the problem of our tax avoidance.

B. What the results of this plan would be:

1. This plan would safeguard the revenue just as the retention of the present graduated corporate income tax would; but

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the estimate under this plan is based on the same data as the Budget estimates and the yield of the House bill; and it cuts down the risk only to the extent of the larger percent of revenue collected at the source.

2. Since all the additional revenue required could be obtained by stopping the avoidance of surtaxes or collecting their equivalent from corporations retaining earnings, as the Message recommended, the following results of this plan must be viewed as samples of the extreme measures which are being suggested as the alternative to getting the revenue needed by making existing surtax rates effective on a relatively small minority now avoiding them:

- a. Increasing the normal tax from 4 to 5% would raise the taxes on everybody. This increase would be greatest on the great mass of the population, which falls in the small income groups. Thus, wage earners, clerks, and the small salaried group generally would have their taxes increased 25% at least. So far as these smaller income groups get dividends, the increase in their taxes would be even more than 25%.
- b. Partners and individual businessmen now paying their normal and surtaxes would all have their taxes increased by the rise in the normal rate. For the great mass of these businessmen with incomes up to say \$6000 this increase would be 25%.
- c. The plan increases the tax of the great body of corporations, which are not operated to enable stockholders to avoid

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surtaxes. The increase in their corporate tax would be from about 19 to 40%; and the smaller the corporation, the bigger the increase, such larger increase affecting the vast majority of the corporations of the country. And they get this increase even though they distribute all their earnings. If they retain 30%, their taxes would be increased from 47 to 74%.

d. Stockholders, under the plan recommended in the message, would pay the 4% normal and surtaxes. Under this plan stockholders with incomes up to about \$6,000 in corporations with incomes of \$2,000 or less, comprising the vast majority of the total of corporations, would have taken out of their share a tax increase of 70% over present law, although earnings were fully distributed; and if 30% of earnings retained, the increase would be about 74%.

3. The President's message stated two objectives -- equalizing the tax burden on business earnings and stopping surtax avoidance. Retaining even the present corporate income tax of from 12½ to 15% would be an abandonment of the first objective, and the 7% supertax proposed would be nothing but lip service to the second objective. It would not prevent those with large incomes leaving earnings in corporations to escape the surtax.

These two changes in the normal tax

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6. ~~This plan~~/would, to get about \$175,000,000 revenue, raise the taxes on 2,700,000 people, operating such as a sales tax, as compared with less than 60,000 people not carrying their due share of the tax burden on that portion of their real incomes represented by withheld profits.

7. The corporate tax recommended in the President's message was constructive from a business point of view since the direct burden was more largely on stockholders. This plan might well be adverse from a business point of view since its direct burden is more largely upon corporate business as well as on partnerships and individual businesses.

8. This plan is unjust and indefensible. ^{Its serious considera-}tion cannot be understood except as ^{reflecting} ~~reflecting~~ a type of desperate measures being proposed as alternatives to facing the responsibility of getting the money needed by merely stopping surtax avoidance in the high income brackets, as the House rates would. The President, the Secretary of the Treasury, and the Commissioner of Internal Revenue and others speaking for the Treasury are all on record that the additional funds required can be obtained by making the personal income tax rates on business profits effective on the minority in the high brackets now avoiding them. The adoption of any such plan would constitute a serious political liability in the face of that record, particularly in view of the fact that already some 60% of our revenues are coming from the consumer class.

II. Defects in the House Bill

The House Bill, while somewhat complicated and at variance with the general plan recommended by the President, incorporates the substance of the President's recommendations and, on the whole, is about as satisfactory in its details as any such bill under the circumstances could be reasonably expected to be. It eliminates the intercorporate dividend tax, but that would be reimposed if the present corporate income tax were retained or could be added as a special tax.

President wrote as follows:—

1. Burden is placed on 2,700,000 people and does not increase in greater proportion on the 60,000 top receivers.
2. House Bill aims to raise all necessary revenue by stopping existing tax avoidance.
3. Corporations Senate Bill hits small Corp. and partnerships and individual businesses exact reverse of House Bill.

TREASURY DEPARTMENT

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INTER OFFICE COMMUNICATION

DATE May 18, 1936.

*Johnson
To be reviewed
& reply HQ
Tuesday*

TO The Secretary
FROM Mr. Taylor

The information available as to foreign currency procedures is not sufficiently complete to make possible a definite and final conclusion as to the application of the German decision in other cases.

It appears most probable that the decision would apply in the case of Hungary. It is probable that it would apply to some commodities in some cases and to all commodities in others from

Argentina,

Bulgaria,

Chile,

Italy

Latvia

Uruguay

There is a possibility that the decision would apply to commodities from

Bolivia

Brazil.

W.S.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE May 18, 1936

To Assistant Secretary Taylor

FROM Messrs. Maffry, Johnson, and Collado
AM *MP* *EC*Subject: Scrip and bond procedures and currency
manipulations - countervailing duties
(Summary of memorandum)

Reference is made to your oral request of May 15, 1936, for a list of the countries whose products may be subjected to countervailing duties under the principles involved in a proposed ruling concerning imports from Germany.

Scrip and bond procedures: A careful examination of the available information indicates that only in Hungary do there exist any arrangements resembling the German scrip and bond procedures by reason of which it is proposed that countervailing duties be imposed.

Currency manipulations: Existing currency arrangements in the following countries have features resembling in greater or lesser degree some of the features of the German currency manipulation which are held by the Treasury to require the imposition of countervailing duties on German goods.

| | |
|-----------|---------|
| Argentina | Chile |
| Bolivia | Hungary |
| Brazil | Italy |
| Bulgaria | Latvia |
| Uruguay | |

Each country presents an individual case. In no instance, with the possible exception of Hungary, can it be stated without qualification that countervailing duties must necessarily be assessed on the products of another country if they are imposed on German products in accordance with the proposed ruling. It should be borne in mind that in respect of several countries on this list only a limited number of products would be subjected to countervailing duties if any should be imposed and that goods on the Free List of the Tariff Act of 1930 may not be subjected to countervailing duties.

The case of Hungary presents the greatest similarity to that of Germany. In Hungary there undoubtedly exists a "discriminatory depreciation," that is, temporary and controlled reduction in the dollar value of selected funds resulting in a special benefit to favored exporters of certain privileged articles. Further investigation must

necessarily be pursued before countervailing duties on particular imports could be imposed.

The remaining countries whose currency procedures appear to fall within the principles of the proposed ruling in regard to German goods may be grouped into two general classes as follows:

Countries in which the application of exchange regulations and restrictions results in special benefits to exporters of designated privileged goods:

| | |
|-----------|---------|
| Argentina | Chile |
| (Bolivia) | Italy |
| (Brazil) | Uruguay |

In Bolivia and Brazil special burdens from which all other export products are exempt are placed upon the exportation of certain selected commodities. The exchange situation in these countries may, therefore, be distinguished from the other four cases in which particular commodities are singled out for special concessions and benefits.

Countries in which the application of exchange restrictions results in an extraordinary premium on dollar exchange which accrues as a special benefit to exporters of all goods to the United States:

| | |
|----------|--------|
| Bulgaria | Latvia |
|----------|--------|

Costa Rica and Paraguay also have "multiple currency systems," but the procedures involved do not appear to fall within the principles of the proposed ruling in regard to German goods.

TREASURY DEPARTMENT

175

INTER OFFICE COMMUNICATION

DATE May 18, 1936.

TO Assistant Secretary Taylor

FROM Messrs. Maffry, Johnson, and Collado
AM *MF* *EC*

SUBJECT: Scrip and bond procedures and currency manipulations - countervailing duties

Reference is made to your oral request of May 15, 1936, for a list of the countries whose products may be subjected to countervailing duties under the principles involved in a proposed ruling concerning imports from Germany.

It is proposed to impose countervailing duties on German exports to the United States of particular commodities dutiable under the Tariff Act of 1930 which are being aided by:

- (1) Payment of direct cash bounties by German industrial associations.
- (2) Scrip and bond procedures.
- (3) Currency manipulations.

It is the latter two cases with which we are now concerned.

Scrip and bond procedures: A careful examination of the available information indicates that only in Hungary do there exist any arrangements resembling the German scrip and bond procedures by reason of which it is proposed that countervailing duties be imposed. These arrangements are set forth below.

Currency manipulations: In considering the problem of currency manipulation, the General Counsel in a memorandum, dated April 15, 1936, to the Secretary of the Treasury, entitled Countervailing Duties on German Goods, states:

"If the problem is to be discussed at all in terms of currency depreciation for our present purposes, the reduced price at which the controlled marks are available to American importers is the result of discriminatory depreciation."

Discriminatory depreciation is further defined for the purposes of the memorandum as a temporary and controlled reduction in value of selected funds occasioned by, resulting in, or the implement of governmental acts in aid of German exporters.

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Examination of the available information indicates that existing currency arrangements in the following countries resemble in greater or lesser degree some of the features of the German currency manipulation by reason of which it is proposed that countervailing duties be imposed.

Argentina
Bolivia
Brazil
Bulgaria
Chile
Hungary
Italy
Latvia
Uruguay

The situation in these countries, as well as in Costa Rica and Paraguay, is to be distinguished from that in other countries in which there is a uniform currency depreciation - that is, for example, in which all export drafts are sold at a uniform rate differing from a so-called "official" or nominal parity rate. In all but two of the countries mentioned above export drafts arising from the sale of selected classes of goods to the United States are sold in part or in whole at rates different from those applied to drafts arising from the sale of other classes of goods to the United States. In the two remaining countries export drafts arising from the sale of goods to the United States are sold at rates different from those applied to drafts arising from exports to some or to all other countries. Excluded from consideration are countries in which export drafts may be sold in their entirety both in an officially recognized market and in an extra-legal or "bootleg" market. However, only in the cases of Germany and Hungary does it follow that the foreign currency is purchased by American importers at more than one rate. In the case of Germany, there exist in the United States separate and distinct markets for different classes of marks, and in the case of Hungary there are in the United States separate markets for blocked and "free" pengoes. In most of the other cases, American importers might conceivably purchase the respective currencies at rates above the prevailing market rates in the United States, but only through ignorance of existing conditions.

In spite of the fact that in all of the countries mentioned above there is a "multiple currency system", each country presents an individual case. In no instance, with the possible exception of Hungary, can it be stated without qualification that countervailing duties must necessarily be assessed on the products of another country if they are imposed on German products in accordance with the proposed ruling. It should be borne in mind that in respect of several countries on this list only a limited number of products would be subjected to countervailing duties if any should be imposed and that goods on the Free List of the Tariff Act of 1930 may not be subjected to countervailing duties.

The case of Hungary presents the greatest similarity to that of Germany. In Hungary, detailed regulations govern payments on merchandise debts and payments to foreign creditors. Banks authorized to deal in foreign exchange are instructed to register amounts received in favor of foreigners under a number of types of accounts, two of which are of immediate interest. Into "Inland Merchandise Pengo Accounts" or "Blocked Inland Pengo Accounts" are paid amounts due from Hungarian importers to foreign exporters. To the latter are credited permissible interest payments and partial principal repayments on foreign debts. Owners of funds in "Inland Merchandise Pengo Accounts" may freely dispose of them in favor of persons residing in Hungary. Owners of funds in "Blocked Inland Pengo Accounts", however, may dispose of them only for specified purposes, an important one of which is the purchase of "additional exports" as defined in the Pengo Transfer Agreement. Under the terms of this agreement, American creditors contracted to pay to Hungarian exporters of "additional exports" in pengoes the value of their shipments plus an extraordinary export premium, which is believed to be in all cases in excess of 50 percent over the "official" rate. In determining the amount of the premium to be paid on any particular invoice of goods, account is taken of the depreciated value of the pengoe in foreign markets and the premium required to enable the exporter successfully to compete in foreign markets.

Hungarian exporters of other than "additional exports" now receive a uniform premium of 50 percent over the official rate for goods consigned to the United Kingdom, United States, Netherlands, Scandinavia, Poland, and Spain. A premium of 38 percent is applied to exports to Belgium, Luxemburg, France, and Switzerland. For exports to Austria, for another example, the premium is fixed at 10 percent.

This summary statement of certain exchange regulations in Hungary clearly indicates that there exist in this country arrangements resembling both the scrip and bond procedures in Germany and currency manipulations amounting to a "discriminatory depreciation", that is, a temporary and controlled reduction in the dollar value of selected funds resulting in a special benefit to favored exporters of certain privileged articles. In none of the other countries which appear on the above list is there a system of exchange control which closely resembles that in Germany and Hungary.

Further investigation of the Hungarian case must necessarily be pursued before countervailing duties on particular imports could be imposed.

The remaining countries whose currency procedures appear to fall within the principles of the proposed ruling in regard to German goods may be grouped into two general classes. One group consists of those

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countries in which the application of exchange regulations and restrictions results in special benefits to exporters of designated privileged goods. These are:

Argentina
Bolivia
Brazil
Chile
Italy
Uruguay

In the case of Argentina, the proceeds from the exportation of Argentine products not generally exported may be sold in a free market whereas the proceeds from the exportation of practically all principal export products must be sold to authorized banks at a lower official rate of exchange. The practical result of this arrangement is to enable exporters of certain designated products to receive larger sums in local currency for their dollar drafts as compared with exporters of other products who are obliged to sell the entire proceeds from their exports at a lower rate of exchange. As of March 18, 1936, the official rate for dollars was 33 cents per peso and the free rate 27.5 cents per peso. A list of commodities, the proceeds from the exportation of which may be thus sold in the free market at a preferential rate is appended.

In the case of Chile, the Exchange Control Commission is authorized to require that up to 20 percent of the value of Chilean exports be returned in foreign drafts and sold to the Banco Central at an official rate of exchange and to fix, in agreement with the Board of Directors of the Banco Central, the percentage of return required on different export products. In order to enable Chilean exporters to take advantage in foreign markets of the low prevailing rates for Chilean exchange this returned percentage has been made very low on a number of products, the percentage ranging from zero to the maximum of 20 percent. Hence, in Chile as in Argentina, exporters of designated commodities are permitted to dispose of export drafts at a higher unit value in terms of local currency than are exporters of other designated commodities. As of March 11, 1936, the official rate for dollars was 5.10 cents per peso and the "export draft" rate 3.77 cents.

The case of Italy is apparently of a similar nature. According to a report dated April 22, 1936, the maximum "compensation" premiums to be paid exporters for exchange have been fixed at 50 percent on exports of agricultural products and at 25 percent on exports of other commodities. Premiums actually paid to exporters on given shipments falling within either of these classifications may vary presumably within the limits established by the fixed maxima.

In Uruguay, the Government has attempted for some time to encourage exports of primary products by releasing varying proportions of exchange for sale in the "controlled free" market at preferential rates. Fifty percent of the proceeds from exports of wool and meat

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are thus released and 85 percent in the case of exports of corn. In addition, the Bank of the Republic is authorized, in cases of the exportation of products in whose manufacture national raw materials are used entirely, to grant the free use of 100 percent of the exchange. The entire proceeds from the export of other products must be surrendered to the Bank at the official rate. In the week ended March 28, 1936, the rate in the official market was about 80 cents to the peso, as compared with 46 cents in the "controlled free" market.

Bolivia and Brazil might be included in the group of countries just considered. In both instances, however, special burdens from which all other export products are exempt are placed upon the exportation of certain selected commodities. The cases of Bolivia and Brazil may, therefore, be distinguished from the preceding cases in which particular commodities are singled out for special concessions and benefits. In Bolivia exchange requirements stipulate that specified percentages of the proceeds from the exportation of tin and other metal ores and other listed products must be surrendered to the Central Bank of Bolivia for the account of the Government at variable rates of exchange below a fixed official rate of exchange. The proceeds from the exportation of other products not specifically provided for are sold at the higher official rate of exchange.

Exchange regulations in Brazil stipulate that exporters of specified products must deliver to the Bank of Brazil 35 percent of the proceeds of their exports in international exchange, the remaining 65 percent to be sold in the free market. The portion delivered to the Bank of Brazil is paid for at an official rate of exchange considerably lower than the prevailing rate in the free market. Exporters of certain selected articles are permitted to sell the entire proceeds of their exports in the free market at the higher rate of exchange there prevailing and thus to receive a larger sum in local currency per dollar of exports laid down in the United States. Exporters of lard, on the other hand, must surrender the entire proceeds from their foreign sales at the official rate of exchange. Exporters of a few designated products must deliver at the official rate percentages varying between 20 percent and zero. As of March 18, 1936, the official rate for dollars was 8.58 cents per milreis and the free rate 5.6 cents. A list of commodities subject to the official exchange requirements is appended.

The other group consists of countries in which the application of exchange restrictions results in an extraordinary premium on dollar exchange, which accrues as a special benefit to exporters of all goods to the United States. These are:

Bulgaria
Latvia

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Under exchange regulations of the type which obtains in these countries and in Hungary, exporters of goods to the United States receive a larger amount in local currency from the proceeds of their exports than do exporters of goods to some or all other countries. This situation is largely the result in each case of an unfavorable balance of trade with the United States, of an attempt to balance trade bilaterally, and of a segregation, in effect, of exchange arising from exports to the United States - conditions which serve to create an extraordinary demand for dollar exchange and therefore an extraordinary premium on dollar exchange. It follows that an exporter of goods to the United States receives a special benefit merely because of the fact that the destination of his shipment is the United States. Shipments by the same exporter to other countries would yield a smaller amount of local currency to the exporter.

Exchange regulations in Latvia admit also of special benefits to exporters of particular goods to the United States. "Compensation" trade is permitted. Importers and exporters arrange among themselves to carry out transactions involving, in effect, a matching of an import and an export of goods. The conversion rate for the foreign currency involved is also agreed upon by the parties concerned. It is, therefore, possible that exporters of particular products might receive an extraordinary premium for dollar exchange which would be paid in effect by the importer as the other contracting party. There is no clear evidence that the system of exchange control in Latvia does actually result in special benefits to exporters of particular goods.

Costa Rica and Paraguay also have "multiple currency systems," but the procedures involved do not appear to fall within the principles of the proposed ruling in regard to German goods.

ARGENTINA--PRODUCTS THE EXCHANGE PROCEEDS OF WHICH
MAY BE SOLD IN THE FREE MARKET

Onyx marble
Cotton linters
Corn bran
Furs of wild animals
Guinea straw
Garlic
Fish guano--fish meal
Tanned hides
Maté
Mica
Oleine
Alfalfa seed
Tobacco
Fruit in general
Glands
Honey
Stearine
Millet
Wine
Butter
Casein

BRAZIL--EXEMPTION OF CERTAIN EXPORT PRODUCTS FROM
THE 35% OFFICIAL EXCHANGE QUOTA

On March 31, 1936, the Federal Council for Foreign Commerce issued a list showing the percentages of exchange arising from exports which are required to be sold at the official rate, consolidating in this list all of its previous resolutions on the subject. The list is as follows:

| | |
|---|------|
| Lard | 100% |
| Animal and vegetable fertilizers; cotton, in fiber, wads and absorbent; rice; refined sugar; rubber gum; cocoa; coffee; preserved meat; chilled and frozen beef; chilled and frozen pork; cottonseed; Brazil nuts, shelled or unshelled; carnauba wax; cigars; cigarettes; old jewelry (on condition that exporter agrees to return corresponding amount of refined gold); salted and dried hides; diamonds valued at more than 10 contos; essences for perfumes; wheat bran; leaf tobacco; herba matte; ipecac; wool; dried and salted tongues; lumber; tripe; hearts, livers--chilled or frozen; bones; skins; piassava; tallow, dried and salted casings | 35% |
| Castor seed | 20% |
| Demerara sugar | 15% |
| Bananas ... 15 Argentine cents or its equivalent per stem | |
| All citrous fruit 6d or its equivalent per case | |

The exportation of jewelry, mined silver, old silver, and worked silver and gold, is subject to special permit.

All other products are exempt from the requirement that a portion of the value of the product exported must be sold at the official rate.

Source: Commercial Attache R. H. Ackerman, Rio de Janeiro, April 2, 1936.

Note: With the exception of frozen and chilled mutton, beeswax and manganese, the products completely exempt from the official exchange requirement are relatively insignificant as a source of foreign exchange.

CHILE—EXCHANGE PERCENTAGE REQUIRED ON VARIOUS PRODUCTS

By the terms of Decree Law No. 646 of September 25, 1932, the Exchange Control Commission was authorized to require that up to 20% of the value of Chilean exports be returned in foreign drafts and sold to the Banco Central at the official rate of exchange and it was given the power to fix, in agreement with the Board of Directors of the Banco Central, the percentage of return on the different merchandise exported.

With the objective of giving all possible facilities to exporters and permitting them to take advantage, in foreign markets, of the low rates for Chilean exchange, this return percentage was made very low on a number of products, as the Bureau has been informed in various reports. The latest ruling on this subject was Decree No. 1458 of April 14, 1936, published in the "Diario Oficial" of April 21, which reduces to 2% the percentage of the value of potatoes which must be returned and sold to the Banco Central.

We are giving below a resume of the products on which local firms have specifically been authorized by decrees to return the various percentages listed on their exports:

| | |
|--|--------|
| Bakelite | 1% |
| Barley | 2% |
| Beans | 3% |
| Beans, broad | 3% |
| Beer | 1% |
| Books | 1% |
| Bottles, empty to Bolivia | 2% |
| Bran and poultry feed | 1% |
| Butter | 2% |
| Cement | 1% |
| Cheeses | 2% |
| Chick peas | 3% |
| Cia. Sud Americana de Explosivos their products | 4% |
| Cristalerias de Chile their products | 1% |
| Fish, in general | 1% |
| Flour | 1% |
| Fruit, fresh | 1% |
| Garlic | 1% |
| Guano, red, phosphate | |
| First 2% of nitrogen | Exempt |
| For each 1% of nitrogen greater than 2% and up to 4% | 1% |
| For each 1% of nitrogen greater than 4% | 2% |

| | |
|--|--------|
| Hats, of wool & rabbit hair . . . | 1% |
| Hay, pressed | 2% |
| Hides, untanned | .20% |
| Hides, tanned | .10% |
| Horses, race | 5% |
| Lard to Ecuador | 5% |
| Lentils | 5% |
| Lemons | 1% |
| Lumber, rough & manufactured . . . | 2% |
| Malt | 2% |
| Matches | 1% |
| Medicines to Peru | 1% |
| Milk, condensed, separated and evaporated | 3% |
| Milk, powdered | 2% |
| Milk products to Peru | 1% |
| Oatmeal | 1% |
| Oats | 1% |
| Ores | Exempt |
| Peas and arvejillas (?) | 3% |
| Pepper, ground | 1% |
| Potatoes | 2% |
| Prunes | 1% |
| Securities | .10% |
| Sheep to Colombia | 1% |
| Shoes to Peru | 2% |
| Sulphate of soda, natural | 3% |
| Sulphur | 2% |
| Talc | 3% |
| Wheat and hulled wheat | 1% |
| Wine | 1% |
| Wool | .20% |

Source: Economic and Trade Notes--No. 370, dated April 25, 1936, to the Bureau of Foreign and Domestic Commerce by Minedee McLean, Asst. Trade Commissioner, Santiago, Chile.

May 18, 1936

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HM, Jr.: Everything I have done I have been very careful about. If I buy or sell Sterling, I do it through the Bank of England. I leave the money on deposit with them. It is not the Federal Reserve; it is the United States

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Treasury that does it. I do not do it through the National City or Chase, but I do it through the Bank of England. Everything that I have done is open and above-board through official channels. I have made two or three gestures, but I am not going to make any more. The next move is from the Chancellor of the Exchequer.

Bewley: Are you referring to the Stabilization Fund?

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Bewley: You realize my position. It is not personal. There is nothing further that I can do. I will report our conversation.

May 18th

Miss Roche wanted to go on some Labor Strike Settlement Board for Harry Hopkins and H.M.Jr. asked her not to go. She was satisfied not to go.



TREASURY DEPARTMENT
COMPTROLLER OF THE CURRENCY
WASHINGTON

ADDRESS REPLY TO
"COMPTROLLER OF THE CURRENCY"

May 18, 1936

The Honorable
The Secretary of the Treasury
Washington, D. C.

My dear Mr. Secretary:

Mr. W. P. Folger, Chief National Bank Examiner of my office, has informed me that the report made by National Bank Examiner H. L. Brown as of January 15, 1935, regarding the indebtedness of Mr. Leo T. Crowley, has been examined by him, together with Mr. R. W. Brown, Mr. Sam Husbands and Mr. William H. McReynolds.

Mr. Folger further informs me that Mr. Crowley was an official of the state bank during practically the entire period covered by the report and was never officially connected with a national bank and states that in his opinion, in which I concur, there is nothing in the report that would require the initiation of any action against Mr. Crowley by the Comptroller of the Currency or the Treasury Department. The report shows that Mr. Crowley was President of the state bank from January 10, 1928 to February 2, 1932, when it was taken over by the First National Bank of Madison. I express no opinion regarding irregularities in the state bank.

Very truly yours,

J. F. T. O'CONNOR
J. F. T. O'CONNOR
Comptroller of the Currency



TREASURY DEPARTMENT

COMPTROLLER OF THE CURRENCY

WASHINGTON

May 18, 1936

ADDRESS REPLY TO
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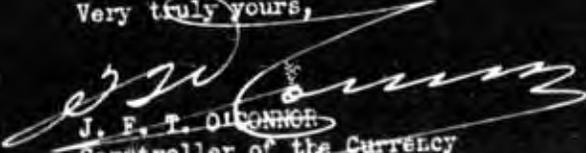
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MEMORANDUM

Comptroller O'Connor and Mr. McReynolds met the Secretary in his office at ten minutes after 11 o'clock on May 18th, 1936, to discuss the report made by National Bank Examiner, H. L. Brown, on January 15th, 1935, regarding the case of Leo T. Crowley.

The Secretary called the Comptroller's attention to the fact that there were three letters which he had addressed to the Comptroller, relating to this matter, which as a matter of record still remain unanswered. He pointed out the fact that the record in the Treasury would be much more satisfactory from a standpoint of the Comptroller's Office if a written reply were made by the Comptroller to these letters; that such reply should state unequivocally whether the facts contained in the Brown report required or justified any action by the Comptroller against Mr. Crowley or any other person; and that in the event no such action was required or justified, as indicated by Mr. O'Connor, the question whether the facts so disclosed justified any action by the President with respect to Mr. Crowley was a matter for consideration - not by the Comptroller's Office or the Secretary of the Treasury, but by the President or whoever he might designate to handle the matter.

Comptroller O'Connor expressed complete agreement with the Secretary and promised to present to him immediately a letter answering the Secretary's letters of March 22nd, 1935, and May 5 and May 6, 1936. The Comptroller stated that his answer would undoubtedly be to the effect that there is nothing in the examiner's report requiring the initiation of any action against Mr. Crowley by the Comptroller of the Currency or the Treasury Department.

McR:gmc



TREASURY DEPARTMENT
COMPTROLLER OF THE CURRENCY

WASHINGTON

May 18, 1936

ADDRESS REPLY TO
"COMPTROLLER OF THE CURRENCY"

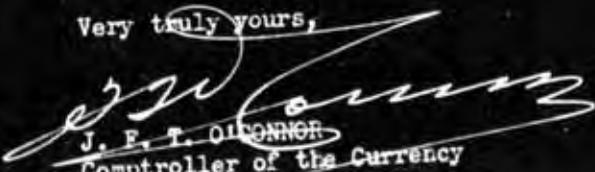
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Comptroller of the Currency

May 13, 1936

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WTF

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Mr. Morgenthau: All of you look very dry -- on the outside.

Well, gentlemen, the Chinese ambassador is here, and Mr. Chen, and the Chinese ambassador has an official copy of the statement which was given out in China and he wants to read that first.

Mr. Sze: The Minister of Finance of China issued the following announcement -- I'll give you copies -- for publication in China this morning, May 18th: (Reads statement).

I might also add that the Minister of Finance at the same time also made another announcement, (this is not here), removing the restriction on the use of silver in arts and industry.

Q. Mr. Ambassador, may I ask what is your note circulation?

Mr. Sze: Seven hundred ninety million Chinese dollars -- yuan.

Q. What is the silver reserve, please?

A. Twenty-five per cent.

Q. Is that what it actually is now or not?

A. More than that now -- four hundred million yuan in silver at the present time -- over fifty per cent.

Q. How much silver are you going to buy, Mr. Secretary?

Mr. Morgenthau: Well, before we come to that, do you men want me to read mine or not? Shall I read it? I'd like to read it if you don't mind -- this is a rather historic occasion today. As a conclusion to our successful conversations with Mr. Chen and the other gentlemen in his mission, I would like to give out this statement which I will read: (Reads Treasury statement)

Q. Am I right, Mr. Secretary, are you inviting representatives from some of the other countries to discuss currency stabilization?

A. Well, it's an official statement by the Secretary of the Treasury and I might say it's just 12 months since I have said anything about international stability and currency.

Q. Mr. Secretary, would some of this dollar exchange which will be made available upon the purchases of silver -- could some of that be taken in gold in accordance with precedent along that line?

A. Possibly, if that's what they desire.

Q. There's no agreement under that so far?

A. It could be done under the agreement, if that's what they wanted.

Q. But no definite arrangements have been made as to percentages?

A. No.

Q. Does this mean the Chinese exchange will be managed in the exchange market in relation to the dollar?

A. Mr. Chen, do you care to answer that?

Mr. Chen: It's in the statement, reading: "An independent system not linked to any foreign monetary unit".

Q. Mr. Secretary, can you tell us anything about the amount of silver you contemplate buying and if you can't tell us that, can you tell us under what conditions you will buy?

A. Which do you want me to answer first?

Q. Either one.

A. Well, the answer as to the amount of silver, I'm sorry, I can't furnish that information, and as to conditions, I can't answer that either.

Q. Will you say how much you'll pay for it?

A. Yes, I can say that. We are going to pay an average price each month of what we pay in the world's market. That's approximately correct. It's a price which will be set each month on the average world price.

Q. What's the average been in the last couple of months?

A. Forty-five cents.

Q. How will that work -- the average? January apply to purchases in February, or what?

A. Well, I don't want to be pressed as to details, but the thing which I want you to know is that we are paying the world price each month.

Q. The market price?

A. We are paying the so-called Treasury price which is posted each day. We will pay that on an average of a number of days. Off the record, I don't want you to get the idea we are paying more or less than the world price; we are paying approximately the world price the Treasury establishes each month -- that's approximately correct.

Q. What is your percentage of silver to gold now?

A. I'd have to look it up; I don't know what it is. Does anybody know?

Mr. Gaston: I think it's approximately twenty--that's a rough guess.

Q. That's less than it was previously.

A. No, it was 18.

Mr. Morgenthau: We will get those figures. After all, there has been \$150,000,000 worth of gold come in recently; I just don't know.

Q. Can you say how soon these purchases will start, Mr. Secretary?

A. Immediately.

Q. Mr. Secretary, how many countries do you have a silver purchasing agreement with now?

A. Mexico, Canada and China.

Q. To refresh our minds, Mr. Secretary, could you tell us approximately what amount was bought in November — \$32,000,000?

A. I wouldn't attempt to do it from memory but we can get the figures for you.

Q. Sixty million ounces for sixty-five cents an ounce—was that your last Chinese silver purchase? You bought some silver from China last December?

A. Correct.

Q. I think it was sixty million ounces.

A. I don't think I ever gave the exact amount or price; you fellows gradually worked it out.

Q. Mr. Secretary, twelve months ago you said the United States wouldn't stand in the way of a currency stabilization agreement; is there any change in the policy in that last sentence?

A. No, there's no change, but for background, if you people will look up the President's message to the London Economic Conference and look at this statement, you will see the two will dovetail together. That and my statement in '33 are the only two which have been made; the things absolutely dovetail.

Q. Mr. Secretary, this puts the two countries on the same sort of metallic base, the same percentage of silver and gold; is there anything about the settlement of international payments between the two countries?

A. No, and the only debts that the Chinese Government owe are to so-called independent agencies; they have all been consolidated into

the Export-Import Bank and they are right up to date on their payments; but I might also say that this agreement, I mean conversations, we have worked out with the Chinese Government follows the spirit of the London agreement on silver; if you will read the London agreement on silver, it's also following out the spirit of that agreement.

Q. Mr. Secretary, I'd like to ask the ambassador or Mr. Chen if they are able to indicate what the proceeds, what the balance of silver would be used for.

Mr. Sze: Stabilization.

Q. There's no question of using any of these funds for purchase of materials in this country?

Mr. Sze: No.

Q. I'd like to ask what price the Chinese will set on silver figuring the silver content of their new coin?

Mr. Morgenthau: I don't know whether they have worked that out or not yet.

Q. The thing I meant was that until recently it was profitable to export coin; will that content be reduced so that it will not be profitable to export it?

Mr. Sze: We haven't quite decided yet.

Mr. Morgenthau: I think the answer is that if there was any marked fluctuation in the price of silver, they have that in mind -- to make the content of the silver in the coin sufficient so that any fluctuation wouldn't make it profitable to demonetize; isn't that right?

Mr. Chen: Yes. If price of silver goes up, we don't want to see it go out.

Q. Is there any ratio of gold and silver in your metallic reserves?

Mr. Chen: No, because under our law forty per cent of the reserve can be in government bonds; forty per cent of the note issue, see, can be in government bonds and sixty per cent in foreign exchange or metallic reserves.

Q. Gold or silver?

A. Yes, but the total for the whole note issue, twenty-five per cent, would be in silver?

Q. Mr. Secretary, may I ask the Ambassador whether they expect to make their branch in New York the depository of considerable amounts of silver?

Mr. Sze: The Bank of China is going to establish a branch in New York; they've already got their license.

Q. And will you have a good deal of silver; will you keep a considerable volume of silver in that branch?

Mr. Sze: No, I don't think so.

Q. Your stabilization fund would be kept in China, not in New York?

A. The stabilization fund would be kept in New York; from previous sales it is all kept in New York.

Mr. Morgenthau: That's a very important thing the ambassador said; the proceeds of previous sales of silver have all been kept in New York on deposit with the Federal Reserve.

Q. How much is the fund in New York?

Mr. Sze: I don't think it would be fair to give the answer.

Q. I thought you told us that -- I wouldn't be absolutely certain.

Mr. Sze: Did I? The fund may be a little more.

Q. I think you stated how much was purchased in November but that didn't indicate the full amount of the fund.

Mr. Ambassador, would you care to indicate whether China will take gold or not?

Mr. Sze: We have part of it now from the last sale.

Q. Could you indicate if you intend to take some for silver under this agreement?

A. I have no instructions on the subject yet.

Q. Mr. Secretary, is that gold paid for the last Chinese silver purchase still being held in this country?

Mr. Morgenthau: Yes.

Q. Do you anticipate this to have any special influence on trade relations.

Mr. Morgenthau: I don't see but what it can have a helpful one on not only trade relations but the relations between the two countries -- can't help but be helpful.

Q. Mr. Secretary, there was a report that at least some of the silver which it was expected China might sell under this arrangement would be kept in China although earmarked for the United States or in possession of the United States banks there; can you or the ambassador say anything about that?

A. I don't care to answer that; I don't know whether you do (To Mr. Sze).

Q. Could you say this -- is it required under the silver purchase act that the silver purchases abroad actually be deposited in the Treasury?

A. That's been the practice which has been followed.

Q. Could you say how much silver you plan to buy monthly?

A. I'm sorry, I can't answer that question.

Q. Will you tell us how much was bought last time -- the earmarking of gold at that transaction?

A. Herbert, did I ever say that?

Mr. Gaston: You spoke of this one transaction, which I believe was fifty million ounces.

Mr. Morgenthau: That's the answer. There were two transactions. Do you (Mr. Sze) have any objections? The first one was nineteen million ounces and the second one was fifty million ounces.

Q. Was there any discussion of a loan to China in these conversations?

A. No, no discussion -- I might say neither by the Chinese nor ourselves; the question was never brought up; is that right, Mr. Chen?

Mr. Chen: Yes.

Q. What are the dates of those transactions, Mr. Secretary, or what year?

Mr. Morgenthau: I have no objection if Herbert looks them up and gives them to you.

Mr. Gaston: Last year.

Q. Mr. Secretary, I'd like to ask the ambassador what the program is for Mr. Chen and his group; do they go to New York for a few days?

Mr. Chen: I'm going to New York for a few days and then back home.

Q. At the end of this week? Going to New York this week then going home?

Mr. Chen: Then going back to China.

Q. Will you be in New York a week or so?

A. Not decided -- maybe not so long.

Q. Mr. Ambassador, how long have these restrictions on the use of silver in art and industry been applied?

Mr. Sze: Since November 15th; it was limited to thirty per cent.

Q. Mr. Secretary, I've thought of one: You were asked whether you could say anything about the amount that would be bought month by month or on a monthly basis and this statement says that the purchases will

be "under conditions". It speaks of one schedule -- or implies a schedule -- of purchases. And then it says it depends on outside conditions. Which is correct?

A. We have a regular schedule covering a definite period.

Q. Are you at liberty to say what length the total period is?

A. No, I'm sorry, I am not.

Q. One year, five years?

A. No, I'm sorry, but I'd deem it not advisable to say at this time.

Q. Mr. Secretary, would you be in favor of conferences between two countries toward the end of international stability of currency as opposed to an international monetary conference of all countries? Would you favor other conferences such as this with the Chinese Government rather than international conferences? Bi-lateral instead of multi-lateral conferences?

Mr. Morgenthau: I didn't know we had a professor with us. Well, talking the language of the Treasury, I'd rather have one country at a time; (in language you and I can understand).

Q. Yes.

Mr. Secretary, what if other countries start this and gang up on the United States; what position would we be in?

A. We have been able to take pretty good care of ourselves in the last three years.

Q. I'd like to be clear on your answer to that-- I understood the question was regarding negotiations for stabilization of currency one country at a time?

- A. Let's go carefully; what the Tribune asked me was this:
You asked me whether I prefer an international monetary conference
or --
- Q. Private negotiations between two countries, such as the Chinese.
- A. My answer was that after experiences I have had with the Chinese,
I prefer to do it the way we have done it with them.
- Q. But the subject of these talks would be on the question of stabilization.
- A. That's all I have the authority for and I am very careful to stay
within my authority.
- Q. Have any other countries suggested such conferences?
- A. Well, I think after this and after a few other things we've got
pending I'm looking forward to the month of July on Cape Cod; I
think it looks very nice.
- Q. Before you go to Cape Code, how about the financing?
- A. We'll do that.
- Q. You couldn't say anything today?
- A. That's Bob's privilege.
- Q. He's slipping.
- A. He's slipping; well, to help Bob out, there's nothing today;
I didn't give you any note either -- any question to ask me, did I?
- Q. Are you going to have any silver questions on Cape Cod?
- A. No, sir. This is going to be a strictly family conference.
- Q. When are you going up there?
- A. Well, we've taken a cottage for the month of July.
- Q. Mr. Secretary, did representatives of the State Department sit
in on these monetary conferences?

- A. I can say this: The State Department has been entirely familiar with the conversations that have been taking place and the result of these conversations, I can say, met with their hearty approval, and I will go a little bit further. Senator Pittman is entirely familiar with this and so is Senator McNary, and I think I can also say that the result of these conversations met with their entire approval; and you might ask, why Senator Pittman? He happens to be Chairman of the Foreign Relations and Chairman of the Silver Committee, and Senator McNary is minority leader and also of the silver committee; so I don't know of anybody else; everybody that has a right to be consulted has been consulted and we feel it has been an excellent arrangement.
- Q. Senator Thomas of Oklahoma?
- A. I feel that when I consulted the Chairman of the Silver Committee that I complied with the niceties of the situation -- that's a good word -- I am sure you will use it.
- Q. Any chance that this financing will come before June 1st?
- A. Oh, this is a little early; this is only the 18th of May; I may begin to talk next Thursday.
- Q. This week:
- A. Possibly. I mean, I say -- I don't know; this is a little bit early; this is too early to talk about the next financing.
- Q. Are you going to carry out this in co-operation with the Federal Reserve officials? I mean, you had the Federal Reserve officials of New York planning with you the last time.

- A. You mean, are we going to bring the Federal Reserve officials down here?
- Q. No— Dr. Burgess of New York.
- A. Well, let's leave all questions of financing until next Thursday and see how the weather is.
- Q. How about taxes? The White House gave out a statement today that the President was principally interested in revenue and didn't care about the form of the bill; does that mean the Treasury will stop advocating the House bill?
- A. Well, far be it from me to interpolate for Mr. Early — that's another good word.
- Q. I mean officials before the committee.
- A. Far be it from me to interpolate for Mr. Early; I couldn't improve on anything Mr. Early says.
- Q. Perhaps I shouldn't have mentioned Mr. Early.
- A. Having mentioned him, I think we will have to let it rest.
- Q. Most people on the Hill think the Treasury is in there every day fighting for the bill; if that isn't true it should be corrected.
- A. I am perfectly willing to rest with Mr. Early. He gave out the statement and from my standpoint it's final.
- Q. What are you going to do about collecting taxes on the Guffey Act now that the Supreme Court has decided?
- A. Well, here's the situation. Herbert tells me that we have collected something like a little over \$650,000 and that's all, and the people over in Internal Revenue are working on it and I am waiting for advice from the Bureau as to what action they recommend; I have received no recommendations so far.

Q. Have you made any expenditure of any consequence under the Guffey Act?

A. Do you know?

Mr. Gaston: No, I don't know; I don't think they will amount to very much.

Q. Will it affect your budget figures?

Mr. Morgenthau: I can't answer that; the thing has happened too recently.

Q. Your estimate was \$80,000,000 that it was supposed to bring in.

A. I don't know -- Herbert?

Mr. Gaston: I don't know.

Mr. Morgenthau: I'll be perfectly honest -- I was at the White House for luncheon from one to three and this has happened and I was preparing for this (silver) and I just haven't had any chance to catch up.

Q. Any resignations or promotions in the Department?

A. Not that I know of -- everybody's happy.

Q. There's a report printed that Mr. Oliphant might resign.

A. I'd be the most surprised man in Washington and the most -- well, it's just out of the question.

2080

The Minister of Finance issues the following announcement for publication in China Monday morning, May 18:

"The Minister of Finance announces that in the light of experience and of additional knowledge of monetary conditions obtained in China and abroad, the Chinese Government deems it desirable to adopt the following measures of monetary reform in accordance with the decree of November 3, 1935:

"1. It will continue to be the policy of the Government at all times to maintain adequate reserves against note issue consisting of gold, foreign exchange and silver, the silver portion of the reserves to have a value equivalent to at least 25% of the note circulation;

"2. For the purpose of completing the reform of the Chinese coinage system, the Government will issue silver coins of fifty cents and one dollar denominations;

"3. For the purpose of further strengthening the position of the Chinese currency, definite arrangements have been made to increase the gold and foreign exchange portion of the note issue reserve;

"The Minister expresses the firm belief that these supplementary measures of monetary reform and the arrangements made will assure the continued maintenance of an independent currency system not linked to any foreign monetary unit and the permanent stability of the Chinese currency which will inevitably lead to greater economic improvement and prosperity of the Chinese people."

*Text of official
Announcement*

*handed to W.C. by Chen
May 18, 10.15, A.M. 1936*

The Minister of Finance takes pleasure in announcing that in the light of experience and of additional knowledge of monetary conditions obtained in China and abroad, the Chinese Government deems it desirable to adopt the following measures of monetary reform to supplement those embodied in the decree of November 3, 1935:

1. It will be the policy of the Government at all times to maintain adequate reserves against note issue consisting of gold, foreign exchange and silver, the silver portion of the reserves to have a value equivalent to at least 25% of the note circulation;

2. For the purpose of completing the reform of the Chinese coinage system, the Government will issue silver coins of fifty cent and one dollar denominations;

3. The restriction governing the use of silver in the manufacture of silver articles, as contained in the regulation promulgated November 15, 1935, will be removed;

4. For the purpose of further strengthening the position of the Chinese currency, definite arrangements have been made to increase the gold and foreign exchange portion of the note issue reserve.

The minister expresses the firm belief that these supplementary measures of monetary reform and the arrangements made will assure the continued maintenance of an independent currency system not linked to any foreign monetary unit and the permanent stability of the Chinese currency which will inevitably lead to greater economic improvement and prosperity of the Chinese people.

TREASURY DEPARTMENT

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Washington

FOR IMMEDIATE RELEASE
MONDAY, May 18, 1936

Press Service
No. 7 - 39

STATEMENT BY SECRETARY MORGENTHAU

The representatives of the Chinese Ministry of Finance who have been in the United States to make some studies of our monetary and banking system, and to exchange views on monetary problems of mutual interest, have completed their mission and are returning to China.

Our conversations with them have been mutually instructive. I feel confident that the monetary program being pursued by the National Government of China is not only along sound lines, but constitutes an important step toward the desired goal of stability of world currencies.

To supplement their efforts toward that objective and to cooperate with them in their program of monetary reform and currency stabilization, and in accordance with our silver purchase policy, we have definitely indicated our willingness, under conditions mutually acceptable, to make purchases from the Central Bank of China of substantial amounts of silver, and also to make available to the Central Bank of China, under conditions which safeguard the interests of both countries, dollar exchange for currency stabilization purposes.

The mission headed by Mr. Chen has been instrumental in bringing about a more complete understanding of our mutual monetary problems.

I believe that only through full and frank exchange of views similar to that which has just taken place between the representatives of the Chinese Ministry of Finance and ourselves will it be possible to improve the internal stability of national currencies and with this achieve a greater international stability.

--oOo--

May 18, 1938

The following is copy of cable received from Buck at Shanghai to the Secretary of the Treasury:

"Kung anxious to give you distinct recognition directly or indirectly through your father, whom he also knows by certain incidents to be friendly to China, for your friendly and helpful cooperation, but fears the present is an inappropriate time. Certain other foreigners at present time are being accorded special recognition for services to China; Forbes and Newton Baker being among them."

May 18, 1936

HM, Jr. called the President at 9:15 this morning. He told him that on the foreign situation things are quiet. The Chinese announcement was given out in China, but has not come over the ticker here as yet.

MAY 18 1936

11.32

CHINESE MONETARY REFORM MEASURES

SHANGHAI- MINISTER OF FINANCE ANNOUNCES

THAT IN THE LIGHT OF EXPERIENCE AND OF ADDITIONAL KNOWLEDGE OF MONETARY CONDITIONS OBTAINED IN CHINA AND ABROAD THE CHINESE GOVERNMENT DEEMS IT DESIRABLE TO ADOPT THE FOLLOWING MEASURES OF MONETARY REFORM IN ACCORDANCE WITH THE DECREE OF NOVEMBER 3 1935

1- IT WILL CONTINUE TO BE THE POLICY OF THE GOVERNMENT AT ALL TIMES TO MAINTAIN ADEQUATE RESERVES AGAINST NOTE ISSUE CONSISTING OF GOLD FOREIGN EXCHANGE AND SILVER THE SILVER PORTION OF THE RESERVES TO HAVE A VALUE EQUIVALENT TO AT LEAST 25 PC OF THE NOTE CIRCULATION

2- FOR THE PURPOSE OF COMPLETING THE REFORM OF THE CHINESE COINAGE SYSTEM THE GOVERNMENT WILL ISSUE SILVER COINS OF 50 CENTS AND ONE DOLLAR ENOMINATION

3- FOR THE PURPOSE OF FURTHER STRENGTHENING THE POSITION OF THE CHINESE CURRENCY DEFINITE ARRANGEMENTS HAVE BEEN MADE TO INCREASE THE GOLD AND FOREIGN EXCHANGE PORTION OF THE NOTE ISSUE RESERVE

THE MINISTER EXPRESSES THE FIRM BELIEF THAT THESE SUPPLEMENTARY MEASURES OF MONETARY REFORM AND THE ARRANGEMENT MADE WILL ASSURE THE CONTINUED MAINTENANCE OF AN INDEPENDENT CURRENCY SYSTEM NOT LINKED TO ANY FOREIGN MONETARY UNIT AND THE PERMANENT STABILITY OF THE CHINESE CURRENCY WHICH WILL INEVITABLY LEAD TO GREATER ECONOMIC IMPROVEMENT AND PROSPERITY OF THE CHINESE PEOPLE

-2-

He also told the President, "I have a press conference at four o'clock and will give the Treasury announcement to the boys at that time. I will invite the Chinese to my press conference." He also quite laughingly told the President, "I received a cablegram from Kung offering me the "Order of the Rising Sun." (Copy of the cablegram is attached.)

"I think that silver will go up and that the Chinese exchange will strengthen, particularly because the Japanese went short on exchange the last couple of days.

"As far as Saturday went, I gather our boys made a good impression on the Hill. They gave Senator Harrison a preliminary estimate on his plan, which was in Saturday's paper, and that will produce over \$640,000,000, but there are a lot of things that counteract each other."

TREASURY DEPARTMENT

214

Washington

FOR IMMEDIATE RELEASE
MONDAY, May 18, 1936 .

Press Service
No. 7 - 39

STATEMENT BY SECRETARY MORGENTHAU

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Our conversations with them have been mutually instructive. I feel confident that the monetary program being pursued by the National Government of China is not only along sound lines, but constitutes an important step toward the desired goal of stability of world currencies.

To supplement their efforts toward that objective and to cooperate with them in their program of monetary reform and currency stabilization, and in accordance with our silver purchase policy, we have definitely indicated our willingness, under conditions mutually acceptable, to make purchases from the Central Bank of China of substantial amounts of silver, and also to make available to the Central Bank of China, under conditions which safeguard the interests of both countries, dollar exchange for currency stabilization purposes.

The mission headed by Mr. Chon has been instrumental in bringing about a more complete understanding of our mutual monetary problems.

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COPY

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"2. For the purpose of completing the reform of the Chinese coinage system, the Government will issue silver coins of fifty cents and one dollar denominations;

"3. For the purpose of further strengthening the position of the Chinese currency, definite arrangements have been made to increase the gold and foreign exchange portion of the note issue reserve.

"The Minister expresses the firm belief that these supplementary measures of monetary reform and the arrangements made will assure the continued maintenance of an independent currency system not linked to any foreign monetary unit and the permanent stability of the Chinese currency which will inevitably lead to greater economic improvement and prosperity of the Chinese people."

9-80

Silver - China

MAY 18 1936

A REUTERS DISPATCH FROM SHANGHAI SAYS IT IS
THOUGHT IN SOME FINANCIAL CIRCLES HERE THAT
CHINA-S NEW CURRENCY REGULATIONS MAY INDICATE
GRANT OF AN AMERICAN CREDIT TO CHINA SILVER
RELEASED BY CHINA BEING PLEDGED AS SECURITY- ON
THE OTHER HAND IT IS POINTED OUT THAT NEW REGU-
LATIONS ARE INTENDED TO ASSURE PERMANENCY OF
CHINA-S INDEPENDENT CURRENCY SYSTEM WHEREAS IF
ANY AMERICAN CREDIT HAD BEEN GRANTED PROVISIONS
WOULD HAVE BEEN MADE TO LINK CHINESE CURRENCY
WITH THE AMERICAN DOLLAR

1145

"MAY 18 1936"

U S-CHINA GOLD AND SILVER DEALS INDICATED

WASHN- THE UNITED STATES TREASURY EVIDENTLY HAS AGREED TO PURCHASE ADDITIONAL CHINESE SILVER THEREBY MAKING GOLD AND FOREIGN EXCHANGE AVAILABLE TO THE CHINESE GOVERNMENT ACCORDING TO THE TERMS OF THE CHINESE-AMERICAN MONETARY AGREEMENT ANNOUNCED IN SHANGHAI

THE CHINESE STATEMENT THAT -DEFINITE ARRANGEMENTS HAVE BEEN MADE TO INCREASE THE GOLD AND FOREIGN EXCHANGE PORTION- OF THE CHINESE NOTE ISSUE RESERVE WAS TAKEN HERE TO MEAN THAT THE UNITED STATES HAD DEFINITELY AGREED TO TRADE GOLD FOR DOLLAR BALANCES FOR ANOTHER LARGE BLOCK OF CHINESE SILVER- THE AMOUNT INVOLVED IS NOT DEFINITELY KNOWN

IN RETURN THE TREASURY EVIDENTLY HAS OBTAINED AN AGREEMENT FROM THE CHINESE THAT THEY WILL NOT DUMP ALL THEIR SILVER ON THE WORLD MARKET THEREBY COMPLICATING THE TREASURY- S SILVER PURCHASE PROGRAM- THE CHINESE AGREE TO RETAIN SILVER EQUAL TO AT LEAST 25 PC OF THE AMOUNT OF NOTES WHICH THEY HAVE IN CIRCULATION

-0-

WCNS158

ADD SILVER

THE PURCHASES ARE INTENDED TO HELP THE CHINESE GOVERNMENT IN ITS MONETARY PROGRAM AND ALSO TO FULFILL CERTAIN REQUIREMENTS OF THE AMERICAN SILVER PURCHASE PROGRAM.

MORGENTHAU SAID THE AGREEMENT WITH CHINA WAS OF A KIND, HELPFUL IN ACHIEVING INTERNATIONAL CURRENCY STABILIZATION. HE INDICATED READINESS TO CONSIDER MORE STABILIZATION STEPS WITH OTHER COUNTRIES BY SAYING THAT HE THOUGHT CONVERSATIONS WITH OTHER COUNTRIES , ONE AT A TIME, WAS A BETTER METHOD OF PROGRESS IN THAT DIRECTION THAN AN INTERNATIONAL CONFERENCE.

5/18--R442P

WCNS159

Add Chinese Agreement

ADD SILVER

THE U.S. IS PREPARED TO PAY CHINA WITH GOLD OR DOLLAR CREDITS FOR THE SILVER IT WILL BUY, MORGENTHAU DISCLOSED. THE AMOUNTS TO BE PURCHASED WERE KEPT SECRET BUT MORGENTHAU SAID THEY WOULD START IMMEDIATELY AND THAT THE PRICE PAID WOULD BE THE AVERAGE MONTHLY WORLD MARKET QUOTATION.

5/18--R444P

FLASH

U.S.-Chinese Silver Agreement

TREASURY TO BUY CHINESE SILVER TO HELP CHINESE MONEY PROGRAM

5/18--R437P

WCNS157

SECRETARY MORGENTHAU ANNOUNCED AN AGREEMENT TO START REGULAR

PURCHASERS OF SUBSTANTIAL AMOUNT OF CHINESE SILVER.

5/18--R439P

ADD. SILVER

THE PURCHASES ARE INTENDED TO HELP CHINESE GOVT. IN ITS MONETARY AND ALSO TO FULFILL CERTAIN REQUIREMENTS OF THE SILVER PROGRAM.

LONGSTRAW SAID THE AGREEMENT WITH CHINA WAS OF A KIND HELPFUL IN ACHIEVING INTERNATIONAL CURRENCY STABILIZATION. HE INDICATED HE DID NOT CONSIDER MORE STABILIZATION STEPS WITH OTHER COUNTRIES BY SAYING HE HAD THOUGHT CONVERSATIONS WITH OTHER COUNTRIES, ONE AT A TIME, WAS A BETTER METHOD OF PROGRESS IN THAT DIRECTION THAN AN INTERNATIONAL CONFERENCE.

FLASH

TREASURY TO BUY CHINESE SILVER TO HELP CHINESE MONEY PROGRAM

5/16-36-37P

WCNS137

U.S. Chinese Agreement

SECRETARY MORGENTHAU ANNOUNCED AN AGREEMENT TO START REGULAR

PURCHASERS OF SUBSTANTIAL AMOUNT OF CHINESE SILVER.

5/16-36-37P

WCNS329

ADD SILVER

THE U.S. IS PREPARED TO PAY CHINA WITH GOLD OR DOLLAR CREDITS FOR SILVER IT WILL BUY, MORSE SAID. THE AMOUNTS TO BE DISBURSED WERE KEPT SECRET BUT MORSE SAID THEY WOULD START IMMEDIATELY AND THAT THE PRICE PAID WOULD BE THE AVERAGE MONTHLY WORLD MARKET QUOTATION.

5X18--R444

WCNS121

SENATOR PITTMAN TODAY RECOMMENDED THAT SOUTH AMERICAN NATIONS ADOPT THE PRINCIPLES OF THE NEW U. S. SILVER AGREEMENT WITH CHINA.

HE SAID THE AGREEMENT FORESHADOWED OTHER AGREEMENTS TOWARD STABILIZATION OF WORLD CURRENCIES AND THAT IN THE FUTURE, AS WITH CHINA, SILVER WOULD PLAY AN IMPORTANT PART. PITTMAN ADDED:

"IT IS THE MOST FAVORABLE STEP IN STABILIZATION OF CURRENCIES IN THE WORLD SINCE THE DISRUPTION OF INTERNATIONAL EXCHANGE ARISING WITH THE DEPARTURES FROM THE GOLD STANDARD. IT IS A PRACTICAL EXAMPLE THAT SHOULD BE FOLLOWED IN ALL LATIN-AMERICAN COUNTRIES."

5/19--R751P.

5-19

FRANKLIN D. ROOSEVELT TODAY CHARACTERIZED THE NEW SILVER AGREEMENT WITH CHINA AS A FINE ILLUSTRATION OF WHAT COULD BE ACCOMPLISHED BY SITTING DOWN AND TALKING THINGS OVER AT A CONFERENCE.

HE SAID THAT THE AGREEMENT SHOULD BE OF AID TO CHINA IN PLACING HER FINANCIAL SYSTEM ON A STABLE BASIS ALONG SOUND LINES CHINA HAS ADOPTED. FROM THE AMERICAN POINT OF VIEW, HE ROOSEVELT SAID, STABILIZATION SHOULD BE HELPFUL BY INCREASING TRADE.

HE SAID HE BELIEVED THE CHINESE FINANCIAL DELEGATION WAS HIGHLY SATISFIED WITH WHAT HAD BEEN ACCOMPLISHED AND THAT THE AGREEMENT WOULD BE OF INTEREST AND VALUE TO CHINA.

MR. ROOSEVELT DECLINED TO BE DRAWN INTO VARIOUS OTHER DISCUSSIONS OF INTERNATIONAL IMPORT. ASKED IF HE THOUGHT JAPAN WOULD WALK OUT OF THE NEUTRALITY TREATY, HE SAID THAT WAS TOO MUCH OF AN IF QUESTION TO BE ANSWERED.

ONE OTHER REPORT WAS HIS CHARACTERIZATION OF RUMORS THAT THE AMERICAN AMBASSADOR TO CHINA WOULD BE REMOVED. HE SAID HE HAD NO BASIS FOR BELIEVING THE REPORT THAT HE

SENATOR MORRAN, IWA CHRISTIAN, WAS REPORTING TO GOVERNOR
HE SAID HE HAD NOT HEARD A WORD ABOUT THE TAX BILL SITUATION
FOR SEVERAL DAYS.

THE TWO THINGS COMPRISE HIS SO-CALLED "MUST" PROGRAM, HE SAID.
ONE WAS MONEY FOR RELIEF AND THE OTHER SOME KIND OF
REIMBURSEMENT FOR OUTLAWED TAXES.

HE SAID THAT THERE WERE MANY OTHER BILLS, PROBABLY 6, 10 OR 12,
THAT HE WOULD LIKE TO SEE ENACTED BUT THEY DISTINCTLY DID NOT FALL INTO
THE MUST CLASS.

MR. ROOSEVELT COMMENTED BRIEFLY ON THE TENURE OF OFFICE OF
CO-ORDINATOR EASTMAN. HE SAID HE HAD SPOKEN TO HOUSE AND SENATE
CHAIRMEN AND TOLD THEM CERTAIN TASKS OF THE CO-ORDINATOR'S OFFICE
HAD NOT BEEN COMPLETED, AND THAT AN EFFORT SHOULD BE MADE TO COMPLETE
THEM. THE MATTER OF EXTENDING EASTMAN'S FUNCTIONS, HE DECLARED,
WAS ONE FOR CONGRESS TO DETERMINE.

MR. ROOSEVELT OBSERVED THAT HE WAS GETTING ALONG WITHOUT A SEAT ON
THE FEDERAL RESERVE BOARD AND THAT HE DID NOT THINK HE
WOULD FILL THE POSITION AT THIS SESSION OF CONGRESS.

The Times, London, May 19, 1936.

228

AMERICAN SILVER PURCHASES

ARRANGEMENT WITH CHINA

From our own Correspondent

New York, May 18

Mr. Morgenthau, Secretary of the Treasury, announced to-day at the end of a fortnight's conference of Treasury officials with representatives of the Chinese Ministry of Finance that the United States had agreed to buy from the Central Bank of China "substantial amounts of silver and also to make available to the Central Bank of China, under conditions which safeguard the interests of both countries, dollar exchange for currency stabilization purposes." Mr. Morgenthau would not state how much silver would be bought, but said that payment would be made at the average world price each month.

The Secretary further said he believed that only through frank exchanges of views such as had passed with the Chinese would it be possible to improve the internal stability of national currency and with this achieve a greater international stability. He made it plain that he was not advocating an international conference at this time. In answer to a question he said he would prefer to confer with one nation at a time.

The Times
(London)

U.S. SILVER DEAL WITH CHINA

"LARGE AMOUNTS" TO BE PURCHASED

STABILISATION TALKS

The United States Government has agreed to buy immediately large amounts of silver from China, to provide dollar exchange in order to help China to stabilise her currency.

This announcement was made last night by Mr. Morgenthau, the United States Secretary of the Treasury, in Washington last night, says Reuter.

He disclosed that the silver would be paid for with gold dollar credits, but refused to reveal how much would be purchased.

Mr. Morgenthau went on to refer to the whole subject of international currency stabilisation.

"I believe," he said, "that only through a full and frank exchange of views similar to that which has just taken place between the representative of the Chinese Minister of Finance and ourselves will it be possible to improve the internal stability of national currency, and with this to achieve greater international stability."

NEW CONFERENCES PLANNED

It is emphasised here, however, that Mr. Morgenthau was not advocating an international conference at the present moment.

Replying to a specific question on this subject, the Secretary of the Treasury said that he would prefer to confer with one nation at a time, but it is understood, according to the Central News, that tentative plans have been made for conferences with other nations.

The Chinese Ambassador, Mr. Sze, said China would use the proceeds of her silver sales for a stabilisation fund.

SILVER DOWN AGAIN

Speculators yesterday were somewhat confused by the new monetary measures announced by the Chinese Finance Minister and reported in "The Financial News."

Chinese and Indian quarters were both inclined to maintain a "Wait and See" attitude, and business was consequently at a low ebb.

Brokers reduced prices by $\frac{1}{8}$ d., the spot to 20 $\frac{1}{8}$ d. per ounce and the forward to 20 $\frac{1}{2}$ d. per ounce, more from the absence of support than from the volume of sales.

See also "Lombard Street," page 6.

LOMBARD STREET

230

CHINESE CURRENCY: SIGNIFICANCE OF 25 P.C. SILVER RATIO

MONDAY EVENING.

Banking circles concerned with China and with silver are unable as yet to form a definite opinion about the significance of the latest monetary measures announced by Mr. Kung yesterday. In the absence of any definite opinion, the price of silver was slightly lower to-day. As a matter of fact, the reform may probably be regarded as being a bull point for silver. Having demonetised silver in November, the Chinese Government has now decided upon its partial remonetisation. Even if silver is only used for token money with an inferior metallic content, it means that the Government will not in any circumstances sell out its entire stock. From a budgetary point of view it is more profitable to issue debased silver coins than to sell the silver at its metallic value against gold to be held as a reserve for the note issue.

Another significant point in the measures is the fixing of the ratio of the silver part of the metallic reserve at 25 per cent.—exactly the figure chosen by the United States. Admittedly, in the case of the United States 25 per cent. represents the maximum, while in the case of China it represents the minimum. This is explained by the fact that, while the American authorities hold less than 25 per cent., the Chinese authorities hold a good deal more than 25 per cent. The aim of both is, however, to arrive at that figure through the acquisition of the metal whose percentage is under the statutory proportion.

A BIMETALLIST VICTORY?

There can be no doubt that the Chinese decision constitutes a victory for bimetalism. When last year China decided to abandon the silver standard, it looked as though the United States would be the only remaining country to fight for the remonetisation of silver. It appeared as though China had thrown in her lot with the Sterling Bloc. The British monetary authorities, perhaps to make it plain that they did not intend to follow President Roosevelt's example in remonetising silver partially, actually substantially reduced their silver stock. The amount of silver coin in the issue department was £869,379 in the last Bank return, a decline of

£920,059 compared with the corresponding figure for 1935.

With the new monetary measures the Chinese Government has broken away from the Sterling Bloc and has adopted the limited bimetalism advocated by the United States. Presumably, the Washington Administration has made it worth while for the Nanking Government to do so by undertaking to convert into gold part of the latter's silver stock. As a result of the transaction, the gold-silver ratio of both countries will make some progress towards its statutory figure.

The Manchester Guardian, May 20, 1936.

231

MONETARY TALKS

United States Invitation to Other Countries

From our own Correspondent

NEW YORK, MAY 19.

The United States Secretary of the Treasury, Mr. Henry Morgenthau, jun., to-day virtually invited bilateral monetary conferences with any and all nations.

In announcing a new plan to aid stabilisation of the Chinese currency, Mr. Morgenthau said the United States was prepared to enter upon a "frank exchange of views" with any other country regarding monetary matters. The United States, however, opposed any general monetary conference at this time.

Under the new scheme which has just been developed the United States is buying a substantial amount of Chinese silver, paying in gold and dollar exchange.

CHINA'S SILVER COINS.

—
TO CONTAIN LESS
PURE METAL.

—
AIM OF CURRENCY
POLICY.

SHANGHAI, 18th May.

China is following the example set by Great Britain some years ago in issuing new silver coins with a smaller pure silver content.

At the same time, the Government has announced other currency regulations, among them being the removal of the restriction limiting to 30 per cent. fineness the silver used in arts and industry.

In some financial circles here, these measures are regarded as intended to further America's desire for a greater commercial use of the white metal, as expressed by the U.S. Secretary of the Treasury, Mr. Morgenthau, at the recent Washington conference with leading Chinese bankers.

In return for this America, it is thought, may extend a credit to China. Thus China would be able to increase gold and foreign exchange reserves against note issues—presumably at the expense of silver.

The silver thereby released would be placed to the credit of the United States as a security for the loan, although it would remain in American banks in Shanghai.—
Reuter.

Details of China's new measures for ensuring the independence of her currency appeared in THE FINANCIAL TIMES yesterday. Chinese bonds were weak in London yesterday. The extent of the fall is shown on Page Nine.

BIG U.S. PURCHASES.

For Dollar Exchange.

WASHINGTON, 18th May.

The United States Government has agreed to buy large amounts of silver from China to provide dollar exchange in order to help China to stabilise her currency.

This announcement was made this evening by Mr. Morgenthau, the U.S. Secretary of the Treasury.

At the same time Mr. Morgenthau opened the door again to foreign approaches on the subject of international currency stabilisation.

"I believe," he said, "that only through a full and frank exchange of views similar to that which has just taken place between the representative of the Chinese Minister of Finance and ourselves will it be possible to improve the internal stability of national currency and with this to achieve greater international stability."—Reuter.

CHINA'S CURRENCY INDEPENDENCE.

THREE SAFEGUARDS.

LARGER GOLD RESERVE FOR NOTE ISSUES.

NANKING, 17th May.

Measures intended to ensure the permanency of China's independent currency system were announced by the Minister of Finance, Mr. Kung, to-day. Under these measures the currency system is not to be linked with any foreign monetary unit. The measures are:—

1. The Government to continue to maintain adequate reserves against the note issue, the reserves to consist of gold, foreign exchange and silver. The silver portion to have a value equivalent to at least 25 per cent. of the note circulation.
2. The issue of silver coins of 50 cents and \$1 denominations.
3. An increase in the gold and foreign exchange portion of the note issue reserve. The Minister further announced the removal of the restriction which limited to 30 per cent. fineness the silver used in arts and industry.

The minting of new dollars with less silver did not imply devaluation as speculators had been trying to make out, said Mr. Kung. The new dollars would be merely token currency similar to legal tender notes. He emphasised that since 3rd November, 1935, the value of the Chinese currency had been divorced from the price of silver in the world market.—*Reuter.*

MINISTER'S CONFIDENCE. PREVIOUS REFORMS.

Mr. Kung says that these new measures have been decided upon in the light of experience gained since the monetary reforms, introducing a managed currency, came in on 3rd November last year.

He declares his conviction that they will lead to greater economic improvement and prosperity.

His announcement is obviously intended to put an end to rumours as to the future of the Chinese currency, to reassure the public of its stability and to indicate the success of the managed currency introduced at the end of last year.

Following negotiations in Washington between Chinese bankers and the U.S. Secretary of the Treasury, Mr. Morgenthau, it had been rumoured that the U.S. was trying to persuade China to go back on silver—*Reuter.*

U.S. SILVER PURCHASES.

SEMBLANCE OF A LOAN.

WASHINGTON, 16th May.

It is rumoured in financial circles that Mr. Morgenthau is conducting negotiations which contemplate the purchase by the U.S.A. of Chinese silver in a manner which would have the semblance of a U.S. loan to China.

It appears that it is suggested that the U.S.A. will buy the silver under the Purchase Act of 1934, but will allow the metal to remain in the custody of American banks in the International Settlement, subject to its return to the Chinese Government upon repayment of the purchase money.

Both the U.S. Treasury and Chinese circles disclaim knowledge of the plan, but some economists consider it to be plausible on the ground that it would avoid the seeming drainage of silver from China, while it would technically place the silver under U.S. control.—*Exchange Telegraph.*

U.S. POLICY AND PRICE OF SILVER.

EFFECTS OF AGREEMENT WITH CHINA.

The latest developments of United States silver policy, so far as they have been revealed, are very interesting, but by no means conclusive. Resulting from discussions with representatives of China, the decisions have had two main objectives. They are intended on the one hand to assist in steadying and strengthening the Chinese currency situation. On the other hand, they will so far fit in with earlier American ideas as to provide assurance against the unspecified amount of silver concerned—rumour has suggested 70,000,000 ounces—remaining as a potential threat to the market and, in theory at least, to remove a force tending to depress the price of the metal. Actually, a further fractional decline to 20½ per ounce occurred yesterday, but this may well have arisen out of nervousness regarding the position of the Chinese Maritime Customs under the impact of intensified smuggling.

Broadly speaking, the agreement seems to be advantageous for China on balance. It is profitless to conjecture what the comparison might have been but for the ill-starred price-raising policy originally adopted by the United States in regard to silver. The important point is that China, having suffered deflation almost to breaking-point, and in consequence abandoned silver as a monetary standard, has enjoyed a substantial recovery on the basis of its new currency system. That improvement obviously should be furthered, as an additional link in the chain of world progress. Assistance in the maintenance of exchange stability should help to attain the desired end. From the standpoint of silver, on the other hand, the significant comparison is between the shutting-off of a potential "tap" and the consolidation of China's determination to maintain primarily gold and foreign exchange reserves against its currency, although these will be leavened by a minimum silver holding

The extent to which age-old tradition and practice will persist internally in face of the less cumbersome modern methods has still to be seen, but officially, at any rate, China has diminished greatly in importance as an absorber of silver. That is scarcely in consonance with the original United States plans to raise the status of the metal, but its reactions doubtless will make themselves felt over a much wider field. One effect which seems probable is that it may serve to divide the silver-producing countries and most of the rest of the world into still more clearly distinct groups, while tightening the bonds between those within the producing category, including the United States.

The authorities at Washington seem tacitly to have recognised the enormous extent to which silver depends upon their support and to have accepted the responsibility which that implies. Centralised and almost monopolistic buying arrangements with Mexico and with Canada have been concluded and there have been indications that these might be the prelude to similar relations with various South American countries. Such support is dictated in part by motives both of policy and of national self-interest. The objective set by United States legislation is a gold-silver ratio of three to one. Precise figures are lacking, but barely two-thirds of the distance—lengthened by every influx of gold—seems to have been covered, according to recent estimates. Any raising of the price, such as first resulted from the silver-buying policy, must therefore have its disadvantages. As against this, it would appear that over 1,600,000,000 ounces of the metal, equal to more than eight years' world production, are already held, so that any fall in world price would mean a serious loss in realisable, as distinct from internal currency, values. That point cannot be ignored in relation to the price level, even though it is an academic one so long as the country's monetary policy as at present laid down is maintained. It might become one for urgent consideration upon the advent of an Administration with different monetary views, but that is another story.

THE STOCK EXCHANGE GAZETTE

May 23, 1936

THE BULLION MARKETWider Movements in Silver

Interesting developments have taken place in the bullion market, particularly in silver. During the previous week, reports that the U. S. Treasury had made further purchases of silver from the Chinese Government stimulated demand from Indian bazaars and speculators, and prices advanced to 20 7/8 d. per oz. for both spot and forward delivery. With buyers disinclined to follow the rise, free offerings on China account and resales by speculators sent prices back quickly to 20 1/16 d. and 20 1/8 d. per oz. for cash and forward delivery by Thursday. On Monday an announcement was made by Mr. Morgenthau that the United States had agreed to buy from the Central Bank of China substantial amounts of silver, and also to make available to that institution dollar exchange for currency stabilization purposes. As the market made no recovery after the news, the effect of the agreement would seem to have been discounted.

A declaration of currency policy by the Chinese Government has complexed the market. The news seemed to be a compromise with the United States as a quid pro quo. China will not return to a full silver standard but, by retaining a 25 percent silver cover for the currency, seems to favour the American idea of bi-metallism.

With the strengthening of sterling the price of gold has fallen. On Tuesday it was fixed at 139s. 11d. per oz., the first time since August last year that it had been below £7 per fine oz. Hoarding demand from Continental centres has varied, but the premium over the franc shipping parity did increase to 10d., almost high enough to induce gold shipments from Paris to London. Over £2,000,000 of the metal has been sold in the open market. The s.s. Stirling Castle, due from the Cape on June 1, has £1,079,332 refined and £64,757 unrefined gold on board. During the week ended May 20 the Bank of England purchased £1,072,317 of bar gold, increasing the influx for the year to date to £5,312,161.

CHINESE CURRENCY AND POLITICS

THE riddle that was set with China's departure from the silver standard is fast being answered. Recent developments are beginning to indicate fairly clearly what is to take the place of the traditional but now defunct silver standard. The force of its tradition has fortunately been recognised and the metal is to play a part both in the coinage and in the metallic reserve of the new monetary system. But the fixed link between the exchange value of the Chinese currency and the bullion value of silver appears to be permanently severed. That this should be so can occasion no surprise and no regret. Silver has proved too feeble a metal to serve as an adequate monetary standard. In joint harness with gold it may still play a part in the currency history of the world; indeed, the initiative taken by the United States and now followed by China in providing for it a defined part in the metallic reserve, strongly suggests that it will. As a monometallic standard, however, its days are over.

The currency measures which were announced by the Chinese Minister of Finance at the beginning of this week include the issue of token silver coinage and the maintenance of adequate gold, foreign exchange and silver reserves against the note circulation. Of the aggregate reserve at least 25 per cent. will have to consist of silver. At first the proportion will, of course, be considerably more than this figure, but thanks to agreements which are being negotiated with the United States it should be possible to bring the figure down fairly rapidly. The discussions which have been proceeding in Washington between U.S. Treasury representatives on the one side and Chinese bankers on the other have in fact made it possible to kill two birds with one stone. The essence of the agreement reached is that China will sell a portion of her silver reserve to the United States against gold or dollars. This progress will be made in reducing the proportion of silver to total reserve in China towards the 25 per cent. mark, while in the United States the transactions will help to lift the proportion of silver in the metallic reserve up to the same figure which through the Silver Purchase Act, is embodied in American legislation. The sales of silver are to be effected in as yet unspecified amounts and will be paid for at the average world market price of the metal in the month in which each operation is completed.

China has, further, undertaken to establish a price central bank which will take over the central banking functions now performed by three Government banks. It will have the right of note issue and in this respect the question of the foreign banks' note issuing rights is likely to come under discussion at no distant date. The new central bank will open an office in New York, which suggests that a considerable portion of the exchange reserve will be kept in the form of dollars—as indeed is the implication of the agreements being made between the Chinese and American authorities.

These provisions for placing silver into circulation as token coins and for determining the nature and distribution of the currency reserve still leave unanswered the all-important question of the standard to which the dollar will adhere. Very wisely no precise indication is being given on this point. The retention of liberty of action is fully justified by the grave uncertainties that still hover over the international currency situation. The Chinese authorities will not drop their anchor until the currency seas are somewhat smoother than they are to-day. Meanwhile they will have an Exchange Equalisation Fund to control the situation and if we may judge by the arrangements that are being made to keep this fund adequately supplied with U.S. dollars it should be safe to assume that for the time being the Chinese dollar will be effectively pegged on its American namesake.

The effect of these developments on the silver market should not be spectacular. There was a resumption of bull speculation in silver when it became known that discussions between the American and Chinese monetary authorities were proceeding and it was encouraged by rumours that large American purchases of Chinese silver would be made at well above the world price of the metal. That speculative bubble has been effectively burst by more precise details of the Sino-U.S. agreement. The silver market may derive negative satisfaction from the knowledge that there is to be no dumping of Chinese demonetised silver stocks in the world market. Beyond that, silver interests can derive no great consolation from the agreement. China remains off silver. The token coins which will be put into circulation will account for part only of the huge stocks of demonetised silver existing in China to-day; they will certainly not call for additional purchases of silver by China in the world markets.

One of the most important aspects of the new currency developments is their political significance. They indicate an interesting rapprochement between China and the United States, a tendency which gains much in importance by its coincidence with the Chinese Customs "crisis." Chinese Customs revenue, on which the service of the various Customs loans depends, is being whittled down by an orgy of organised smuggling in Northern China, where the evasion of the Customs has received the scarcely veiled approval of the Japanese authorities. The matter has been made the subject of a most outspoken official complaint by the Inspector-General of Maritime Customs, and joint representations are to be made to Tokyo on this matter by the British and American Governments. This represents the first clear-cut instance in which the rights of the United States and of Great Britain in China have been openly and equally assailed by the reactions of Japanese penetration in Northern China. The currency rapprochement between China and the United States appears to promise far more decisive and effective co-operation from Washington in the impending first real trial of strength between the Treaty Powers and Japan in China.

May 19, 1936

McReynolds, Upham, Bell, Kent, Russell, Helvering, Haas, Seltzer, Turney, Gaston, Oliphant and Taylor met with the Secretary.

Oliphant suggested: "There is no one thing more important from a legislative standpoint than that Vinson should be on the Conference Committee. As it now stands Doughton is first, Hill second, Cullen third and Vinson fourth. Cullen is just a layman. Vinson would be equal to anybody that the Senate sends. He is a master of the subject." Oliphant's implication was to move Vinson up so that he would be assigned to the Conference Committee and in order to do this, Hill would have to be transferred to the Board of Tax Appeals immediately.

HM, Jr.'s reaction to Oliphant's suggestion was: "My own inclination is that it is 'hot stuff' and my advice would be to keep away from it. I would not suggest anybody for the Conference Committee." Guy Helvering offered as his opinion: "It is pretty dangerous to suggest anybody." Continuing, HM, Jr. said, "None of us are close enough to these people to make any suggestions. I think your point is clever, but I think it is dangerously clever." Oliphant's reply was, "I cannot suggest just how to do it, but I thought it sufficiently important to bring it up."

The Secretary asked Mr. Helvering to send him, today, a recommendation as to what he is going to do on the Guffey Coal Bill taxes in view of the Supreme Court's unfavorable decision. (Copy of Mr. Helvering's memorandum is attached.)

As the group was leaving, HM, Jr. asked Bell and McReynolds to stay behind. Bell said that the Flood Relief Bill has a chance of becoming law; that there were \$315,000,000 involved as it passed the House, but that by the time all of the amendments are passed he did not know what the final amount would be; that the Flood Relief Bill is in the Senate now and Senator Copeland's Committee handles this Relief Bill. HM, Jr. arranged with Colonel McIntyre that Bell and he would see the President, but no definite hour was set for the conference.

May 19, 1936

Memorandum for the Secretary:

In light of the decision of the Supreme Court holding the Bituminous Coal Conservation Act of 1935 invalid, I prepared a telegram addressed to the Collectors advising them to suspend the collection of taxes imposed under this Act, which telegram is now in Mr. Oliphant's office. Mr. Oliphant communicated with Justice, and the Solicitor General requested that the despatch of this telegram be postponed for a day or two.

After clearance with Justice, Collectors will be instructed, on behalf of taxpayers, to file blanket claims for abatement covering all outstanding assessments relating to this tax.

Collections up to May 1, 1936, amounted to \$674,885.49; this sum plus the collections in May are subject to refund. Following the usual procedure relating to refunds, taxpayers will file claims for the refunding of taxes paid.

The appropriation made for taxes erroneously and illegally collected covering the current fiscal year is sufficient to meet this additional expenditure. It will, therefore, not be necessary to ask for a deficiency appropriation.

Commissioner.

GTH:bc 5-19-36

MEMORANDUM

Secretary Morgenthau, Jesse Jones, Marvin McIntyre, and Mr. McReynolds met in the Cabinet Room at 11:15 o'clock, May 19th, and discussed action to be taken in the case of Leo T. Crowley. Messrs. Jones and McIntyre maintained since the actions disclosed by the bank examiner's report took place prior to 1932 and any possible criminal liability had been wiped out by statutes of limitation, nothing further should be done and the case should be closed. The Secretary took the position that the actions disclosed are of so serious a nature that Mr. Crowley should be given opportunity to disprove or explain them and if not cleared up he should not be permitted to retain his present position of responsibility.

As a result of this disagreement, the President was consulted by the entire group. After some discussion it was agreed that he would delay his decision until a later date when he would discuss it further.

McR:gmc

May 19, 1936

Before the 9:30 group came in, HM, Jr. asked Locnhead to look into the possibility of purchasing gold in India and shipping it to London to be held there, in order to build up a stock of gold outside of the country in case of an emergency. The price of gold yesterday in India was quite low.

We got a memorandum inclosing a copy of the Permanent Monetary Policy compiled from studies made by the Business Advisory Council. Roper had sent it to the President for study as the plan, he said, was to make early release of it. The President, in turn, sent it to HM, Jr. to read. The latter took it with him to the Farm over the week-end and read it on the plane from Washington. He was terribly upset because he felt it would be a great mistake to make it public.

When he arrived at the Farm he immediately called Kannee at the White House and told him to tell the President that this report should not be given out. Kannee called back and told HM, Jr. that the President himself called Roper and told him that he, the President, had read the report, considered that parts of it were good, but that it was dynamite to give it out and told him to see that this was not given out.

Late Saturday, Grace Tully called the Secretary and said that the President wanted HM, Jr. to be sure to talk to him about the report on Monday, but before doing so he should see Eccles on Monday morning and discuss it with him. Accordingly, HM, Jr. talked to Eccles who was very much in agreement with the Secretary. Eccles prepared the attached memorandum which HM, Jr. sent on to the President.

HM, Jr. also talked to General Wood, who is Chairman of the Committee which worked on the report, and the following is a record of their conversation:

May 18, 1936

R. E.
Wood: Hello

HMjr: General Wood -

W: Yes

HMjr: I have in my hand a copy of the Permanent Monetary Policy for United States to be - which has been gotten out by you.

W: You mean that Committee Report?

HMjr: Yes

W: Well you shouldn't have it boy.

HMjr: What?

W: I say you should not have that.

HMjr: Why not?

W: Unless - did Roper give it to you?

HMjr: No the President of the United States gave it to me.

W: Oh well then it's all right.

HMjr: Oh, is it?

W: I mean that isn't released for publication or anything.

HMjr: It isn't?

W: No, because the Council hasn't passed on it.

HMjr: Ah ha

W: We always give a copy of those Committee Reports to the Secretary of Commerce and to the President.

HMjr: Yes.

W: But the Council hasn't passed on it at all yet.

HMjr: Oh

W: And won't pass on it till June.

HMjr: Oh, this is just a Committee Report?

W: This is just a Committee Report to the Council.

HMjr: Well how did - I didn't think that you were a member of the Council any more.

W: Yes, I've been a member of the Council.

HMjr: Well, isn't there - isn't this sub-committee - isn't this practically the Committee of the Nation?

- W: No, no, Carl Calkins and Delancy Cook - Rand and I were the only members of the - the only men on it who were members of the Committee of the Nation.
- HMjr: Ah ha -
- W: Henry Harmon, Delancy Cook and Carl Calkins were never on the Committee of the Nation.
- HMjr: Ah ha - Well, I suppose Earl Hardy did all the work - ?
- W: Well, he did all the writing.
- HMjr: He did all the writing and - of course the thing that sort of surprises me is that a 'Permanent Monetary Policy of the United States' should be gotten out without even Mr. Eccles or I being told or even consulted about it.
- W: Well listen - we don't presume to get out a 'Permanent Monetary Policy'.
- HMjr: Well, that's what the title says.
- W: Well, I know it but I mean we don't have the authority - we're just submitting our views to the Council.
- HMjr: I see.
- W: Now if the - and that cannot be released without the authority of the Council. The Council doesn't meet until June, see?
- HMjr: Yes
- W: Now if the Council approves it it will be presented formally to the President with his approval.
- HMjr: Yes
- W: Then it is up to the President - the President of the Council agreed that none of these Committee Reports would be published without his authority, see?
- HMjr: Yes
- W: Then he can either pigeon hole it or do anything he damn pleases with it.

HMjr: Ah ha

W: I think it isn't up to us - those --

HMjr: Well, it - it - it - it ---

W: That's our recommendation.

HMjr: Well, it's 100% Committee of the Nation work which is - has just been turned into the Council - isn't - wasn't that about what you'd say?

W: No I wouldn't say it - read it.

HMjr: I have read it.

W: There - there - for instance the Committee of the Nation recommended certain fixed prices for gold - recommended raising the prices of gold - there's nothing of that in there at all.

HMjr: Ah ha. I have read it.

W: Well, I mean there's a great many things in that that are different from the original views of the Committee of the Nation.

HMjr: Yes. I've also read the report by Sir Charles Morgan Webb.

W: Yes

HMjr: And you - and I - and I can't tell an awful lot of difference between the two of them.

W: Except there's a good deal of more additional data in there.

HMjr: Yes, but it follows a good deal that line doesn't it?

W: A good deal yes.

HMjr: Well of course I don't mind saying that when Great Britain and the English bankers are going to run the United States fiscal policy why it'll be over my dead body.

W: Well good God! - it will be over mine but I don't see that they are going to run it.

- HMjr: Well, if you do this we just join the sterling area and we'll let London tell us how to do it and when to do it and so forth and so on.
- W: Oh, I don't think that at all. I think it puts it in our own hands.
- HMjr: Yes, well there's where it is now. It's in our own hands and we control it for the first time in a century.
- W: Well - but my view in that entirely coincides with yours.
- HMjr: Yes
- W: Because I don't want to - and I fought any dependence on England.
- HMjr: Yes, but every quotation to substantiate this report is practically an English quotation, an English economist, an English bank - English monetary report.
- W: Oh, just wait a minute though. Those quotations are taken to show - largely taken to show that English industrialists have had some independence in mind in monetary matters and that they worked guided by Montague Norman, of the Bank of England. That was the purpose of those quotations.
- HMjr: Yes, but if you want to get out a report, Mr. Eccles, for instance, testified for 11 days in the House on the question of whether we should or should not have a monetary authority in this country.
- W: Yes
- HMjr: And there isn't a single quotation from Mr. Eccles in this whole report. Not one - not one. It's absolutely a one-sided report. There's 11 days of testimony of Mr. Eccles before Congress.
- W: You mean on that old Vosburgh (?) bill?
- HMjr: Yes - on the question of the monetary authority.
- W: After all, Mr. Morgenthau, we knew this report would be referred to you. The real purpose of the report --
- HMjr: Oh pardon me, you didn't know it would be referred to me.

W: Why certainly I knew it would be referred to you.

HMjr: How?

W: By the President.

HMjr: Well, it has been and --

W: Why of course we knew it would be referred to you. Just remember that we're thinkers. Those reports are made up by Committees; they go to the Council - in this particular case the reports have been sent to the members of the Council and the members of the Council will vote at their next meeting whether they recommend it or don't recommend it. If they recommend it the report goes to the President.

HMjr: I see.

W: Now say the report for the Social Security Bill. We do it with the exception of the Secretary of Labor. Report on Housing will go - we know will go to the Secretary of the Interior. If the various Cabinet officers think there is anything of merit in the Committee Report they tell the President and, by special agreement with the President, one report of the Committee was published without his knowledge. It was agreed that no - none of these Committee Reports would ever be published --

HMjr: But Mr. - General Wood - at the beginning of the conversation you - you - you seemed most surprised that I had the report and said I shouldn't have a copy.

W: Yes, before the Council acts on it.

HMjr: Oh -

W: But after the Council acts on it of course we know it will go to you.

HMjr: Ah ha - well ----

W: You understand it hasn't approved this report?

HMjr: Pardon me?

W: The Council you understand has not approved this report?

HMjr: Well, I didn't know that. I did not know it and

there was no way I knew it because the President sent this over to me and I have no way of knowing and I'm sure that he doesn't know that the Council has not --

W: Well, he ought to know it because Mr. Roper should have told him.

HMjr: Well, I have Roper's letter right before me and he makes no reference to it.

W: Well, the Council meets June 18th and that's when it will take action on this report.

HMjr: Yes - Let me just read you from the beginning of Mr. Roper's letter. It says, 'My - ' I mean, 'Dear Mr. President: - This report on 'A Permanent Monetary Policy for the United States' represents one of the most extensive studies conducted by the Business Advisory Council. This study has almost a year of intensive research behind it and represents the well-thought-out and concurrent views of the committee members listed on page one. The plan now calls for an early release of this study, for one reason, to forestall ---

W: Wait a minute. I didn't get that - 'the plan now calls for - ' what?

HMjr: Just a moment. 'The plan now calls for an early release of this study, for one reason, to forestall the financial survey of.....' Well, it goes on - I suppose that's confidential but he said the plan now calls for an early release. The reason I'm calling you - in the last paragraph he says here, 'As soon as the President has perused this report, it seems desirable to give it the earliest possible release, since copies are in the hands of the Council members and there is great danger that as usual there may be 'leaks' which would destroy the effectiveness of a general national release.'

Now, let's be fair with one another - after reading that I'd have no - nothing to judge by but what there was going to be an immediate release.

W: Well I - I - I agree with you from the wording of -

HMjr: That's why, frankly, I'm excited because if I thought that I had time to sit down and discuss

the thing with you before it was released I wouldn't have called you on the phone but here comes a memorandum over and it said - talks about immediate release and I frankly got disturbed. I mean if I could sit down and discuss it with you for a couple of hours why then we might have a meeting but the fact that somebody just puts a gun to my head and says, 'there's going to be an immediate release' - it doesn't give me a chance to turn around.

W: Well, listen, I suggest either you call Roper or I'll call Roper as his Secretary has evidently forgotten that that report cannot be released until the Council passes on it.

HMjr: Well, what I would suggest is this, if you don't mind, I'm lunching with the President and he asked me particularly to take this up with him at lunch.

W: Yes

HMjr: Now after I've had lunch let me call you back.

W: All right.

HMjr: How will that be?

W: Of course I'm as anxious not to have it released as you are, perhaps in that if this thing was released before the Council passed on it --

HMjr: And then they ---

W: There'll probably be a very considerable difference of opinion in the Council itself.

HMjr: And then they rejected it.

W: What?

HMjr: And if they should reject it?

W: Well, I mean if it were released. We'd - I'd be in the position of double-crossing my own Council.

HMjr: I see. Well, if you don't mind - let me have lunch with the President - let me come back and then call you on the phone.

W: But I'd also suggest you call Roper up too.

HMjr: Well, I've had no communication from Mr. Roper - this comes to me from the President.

W: Oh, I see. I mean - I thought you said you had a letter from Roper.

HMjr: No, I'm reading you a letter from Roper to the President.

W: Oh, I see, I thought it was to you.

HMjr: No - no. Which Roper - here's a letter addressed by Roper to the President enclosing this book. The President sent it over to me and asked me to study it with Mr. Eccles and then talk to him about it.

W: All right.

HMjr: Now the President keeps his line straight, the way he always does on any financial monetary matter - he sends it over to me - asked me to study it and then advise him. But it went from Roper to the President - the letter and the report - and then from the President to me. Then I got disturbed and I'm calling you. I've not discussed this with Roper.

W: Well, supposing you tell the President -

HMjr: Yes

W: That that report has not been acted on --

HMjr: I will.

W: - either by the Executive Committee or by the Council.

HMjr: I will.

W: And that it certainly must not be released until the Council has passed on it and then of course it's purely a question for him to release because the Council agreed that they would never release a report unless he told them to do so.

HMjr: Well, of course last year we had a very unfortunate experience that was said about the Tax Bill - they had a report --

W: Yes, that was very similar. Well this was in a - as a result of that that we agreed not to release these.

HMjr: You remember that case?

W: Yes, I remember it.

HMjr: Yes, well --

W: The President was very much upset over it.

HMjr: Yes, well thanks very much General and I'll call you and, if you don't mind, I'd rather that you didn't call Roper until I have a chance to talk to the President.

W: All right, and also tell the President --

HMjr: Yes

W: - that I am just as anxious - I mean - I, for a different reason, am just as anxious to prevent the release of that report as you are.

HMjr: I understand. You want to keep good faith with your members?

W: I want to keep good faith with my members. It would be a hell of a thing if the Committee Chairman released the report - had it released before the fellow members had a chance to discuss it or act on it.

HMjr: O. K.

W: All right.

HMjr: Thank you.

COPY

THE SECRETARY OF COMMERCE

WASHINGTON

May 4, 1938

Honorable Franklin D. Roosevelt
President of the United States
The White House
Washington, D.C.

Dear Mr. President:

This report on "A Permanent Monetary Policy for the United States" represents one of the most extensive studies conducted by the Business Advisory Council. This study has almost a year of intensive research behind it and represents the well-thought-out and concurrent views of the committee members listed on page one. The plan now calls for an early release of this study, for one reason, to forestall the financial survey of the New York State Chamber of Commerce which will be highly critical of the Administration's monetary policy, but the Council does not wish to release this study until it has had your perusal.

The first four chapters of this study strongly defend the Administration's monetary policy. It is pointed out, for example, that the leading English authorities heartily agree that the action taken by the President at the time of the London Economic Conference was entirely sound and proper. The first part of the book offers a detailed comparison between English and American monetary policies and the emphasis is quite favorable with respect to what the Roosevelt Administration has done.

Chapter seven on "The Administration's Monetary Problem" says in effect that money should be a tool and not a god and that the Roosevelt Administration has taken the first steps in the proper direction properly to relate inherent monetary functions to national economic needs.

The conclusions and recommendations are given in Chapter 9, which begins on page 135. The general conclusion is that we should have a managed currency and a specific recommendation is made as to how this can be achieved in a suggested draft of a bill, beginning on page 148. This bill creates briefly a federal monetary authority which shall

issue a circulating currency in such amounts as the authority from time to time finds necessary to carry out its powers, all other authority of law to issue or re-issue currency gradually to be abandoned.

The monetary authority would be empowered to buy and sell gold and silver, to rediscount for any Federal Reserve Bank notes, drafts, bills of exchange, etc., bearing the endorsement of such Federal Reserve Bank, to purchase and sell foreign exchange and to purchase and sell in the open market bankers' acceptances and bills of exchange.

As soon as the President has perused this report, it seems desirable to give it the earliest possible release, since copies are in the hands of all Council members and there is a great danger that as usual there may be "leaks" which would destroy the effectiveness of a general national release.

Very sincerely,

(Signed) DANIEL S. ROPER
Secretary of Commerce.

Enclosure

May 20, 1936

MEMORANDUM ON COMMERCE COMMITTEE'S REPORT ON PERMANENT
MONETARY POLICY

I have given full consideration to the report of a special committee of the Business Advisory Council on "A Permanent Monetary Policy for the United States" and my views are:

1. This is only another form of the so-called central bank scheme promoted by the Committee for the Nation, by the Goldsborough Bill introduced in the House on January 29, 1934, and by various others of the Professor Warren-Vanderlip-Senator Owen school of quantity money theorists and commodity dollar enthusiasts.

2. For this report to be issued with any suggestion of Administration endorsement would not only be a repudiation of the sound principles represented by Administration monetary and banking policy so far, including the Banking Act of 1935, but would inject at a most inopportune time a dynamite-laden issue which, in my judgment, would have the most damaging possible effects politically and economically. It would literally shock the banking and business community.

3. The substance of these recommendations calls not only for a scrapping of the existing banking system, including the Federal Reserve, but for a revolutionary change beyond anything undertaken or, so far as I know, even contemplated

by any country in the world.

4. This bears all the earmarks of a roundabout attempt to promote through the Commerce Department a scheme on which neither the Treasury nor the Reserve System, which are the responsible authorities, have been consulted. To give it any color of Administration approval would, in my judgment, precipitate a storm of attack and be a blunder of the first magnitude.

BUREAU OF INTERNAL REVENUE
OFFICE OF
CHIEF, INTELLIGENCE UNIT

254

May 20, 1936.

MEMORANDUM FOR THE SECRETARY:

Further information with respect to the New Orleans situation is contained in the attached copy of a letter addressed to me by Special Agent in Charge Burford on May 19th and the copy of the memorandum prepared by Mr. Burford on the 14th instant.

I showed these letters to Mr. Jackson this afternoon. He is making an effort to arrange a conference between himself, Mr. Oliphant and me to discuss ways and means of handling these cases.

Mr. Jackson tried to get you while I was in his office, but could not do so. He told me he had talked with the Attorney General, the Solicitor General and Assistant Attorney General Keenan; that the Attorney General did not know much about the matter and left it in Mr. Jackson's hands; that the Solicitor General likewise did not know much about the New Orleans situation; and Mr. Keenan was very much perturbed about the situation, especially with respect to the part which he is alleged by Mr. Viosca to have played in the dismissal of the case against Weiss.

Mr. Jackson has not yet been able to determine a definite course of action with respect to the future handling of these cases, and it is for this purpose that he plans to have the conference.

I shall send you a further memorandum as soon as this conference is held.



Encs.



TREASURY DEPARTMENT

INTERNAL REVENUE SERVICE

Post Office Box 1390,
New Orleans, Louisiana, May 19, 1936.

INTELLIGENCE UNIT

Dallas

(Name of Division)

Chief, Intelligence Unit,
Bureau of Internal Revenue,
Washington, D. C.

In response to our telephone conversation the following is submitted as to the activity of Mr. Viosca as it may relate to the final disposition of the criminal cases pending here.

There is attached a memorandum which I dictated immediately after the proceedings in the Louisiana Quarry case and which with prior letters gives you the situation as it appears to us.

Friday evening May 15th Governor Moody telephoned and said that Viosca had written him and had telephoned him for an expression as to whether he thought the cases against Seymour Weiss could be successfully prosecuted and whether or not they should be prosecuted. I understood from the Governor that he proposed to tell Viosca substantially that the acquittal of Shushan had materially reduced the chances of obtaining convictions and that probably the lenient sentence imposed by Judge Foster would be influential on a jury; but that as he recalled the cases they were based upon substantial evidence and that he believed the offenses had been committed and that the evidence was sufficient to warrant going to trial. Governor Moody, as I understand it from him, told Viosca that he was going to call me for some details. Since that time I have not heard from Mr. Viosca nor have I seen him but Norman (assistant to Mr. Viosca), told me that Viosca had written the Attorney General's Office hoping for some comment as to whether he should set the Mississippi Valley case for trial June 15th or let it go over until fall. He also told Norman he understood that Senator

Joseph Robinson was angered because R. S. Wilson had been required to enter a plea (it was only nolo contendere) as Senator Robinson had been given to understand in Washington that Wilson would not have to plead guilty.

I was in telephone communication with Viosca several times Friday, May 18th, during which he said that he was making overtures to counsel for the Nelson Brothers and the Ex-Congressman Reid had given him reason to believe late Friday that they would appear Saturday morning and enter pleas.

During several conferences I had with Mr. Viosca during the latter part of last week he said that he had been in communication with Assistant Attorney General Keenan who had indicated to him that, since Governor Leche was much interested in Seymour Weiss and the other cases, he gained the impression that it was the desire of that Department to dispose of all of these cases in any manner possible. He said that he had discussed the nolo contendere pleas and said it was satisfactory and that Keenan had authorized him to handle the dismissal of the Seymour Weiss indictment and the Quarry case in any manner he saw fit. The conversation was held the night before they entered their pleas on the 14th. As previously related I knew nothing of these pleas until called by Viosca immediately prior to his appearance in Court. (See memorandum attached).

I learned in very strict confidence from the party, as I told you over the telephone, that he was present at a conference with the Governor and others and it was agreed that they would not disturb Mr. Viosca in his position and at the next session of Congress they would submit his name for confirmation. He said the early disposition of these cases was at issue.

As a sample of Mr. Viosca's small tactics it was learned definitely that he made a trip to Baton Rouge Sunday, May 17th, with the driver of a laundry route whose appointment he recommended strongly to Governor Leche for the position of Highway Patrolman. The party in question proudly told yesterday of Mr. Viosca's action and that he was present during the applicant's so-called oral examination for the position.

Mr. Viosca expressed some concern to Mr. Oftedal (Special Agent) and Norman of the remarks which the public have made generally regarding his request of the Court to dismiss the Quarry case against Seymour Weiss. I urged him just prior to his doing so

to wait. His reason for immediate action was that he wished to dispose of that case completely at that time. After coming out of the Court room he asked me what I thought about it and I replied, "it does not make any difference now; it is already dismissed and understand me correctly those kind of matters are your, 'little red wagon'".

A serious question naturally arises as to the effect of the acceptance of the nolo contendere pleas and the lenient sentences on a jury in the immediate future when considering whether the Mississippi Valley case should be immediately brought to trial or held over to the fall term.

Mr. Viosca called me about four o'clock this afternoon and said that Harry B. Nelson and Wilkinson were coming in to see him Thursday. He said that thus far John P. Nelson had refused to agree to enter a plea of guilty. He said Harry wanted to particularly convince him that the amounts paid on the amended returns filed after the completion of the investigation were more than they actually owed.

Mr. Viosca said that he thought he might be able to work out something that would permit him to dispose of the case perhaps by a superseding indictment against the Corporation, to which Harry as president might plead so that the Government could be assured of the taxes and penalties. He said he could conscientiously agree to dismiss the case against W. W. Nelson as he felt he was but little more involved than the other brothers who were not indicted.

I asked him if he desired Revenue Agent Rowe and Special Agent Oftedal to be available for a conference as to the liability, etc., and he said "yes", but that he thought Nelson intended the conference with him should be private. I have wired Millsap to be here tomorrow if possible and Thursday for a certainty.

I am leaving tonight for Jackson, Mississippi, on account of the urgency of Senator Herring's requests re Billups and will be back in New Orleans Thursday morning and will advise you by telephone if there are any developments.

The Nelson case is a good one and I do not believe it should be disposed of by anything less than unqualified pleas of guilty to all indictments by both Harry and John P. Nelson. I see no objection to the dismissal against W. W. Nelson if the above is carried out.

A. D. Burford,
Special Agent in Charge.

New Orleans, Louisiana,
May 14, 1936.

MEMORANDUM in re UNITED STATES ATTORNEY VIOSCA.

My knowledge that pleas were to be entered as to Kenny the O'Dwyers and the Kargers is set forth in prior, personal, confidential letters to the Chief.

A day or two prior to the Fernandez plea I was told by Viosca that Fernandez might be persuaded to enter a plea providing the tax was reduced. I very pointedly told Mr. Viosca that the tax was based on Fernandez' own statement and there would be no basis for a reduction of it. He later called and said that Finnorn was trying to raise the amount of tax stated in the indictment. I was not present nor notified, but understood that Fernandez entered a plea in the Judge's chambers one afternoon and would be sentenced the next day providing he paid over to the Clerk the amount of money less the \$500.00 offer in compromise which \$500.00 was to be applied on the tax.

I knew nothing of the contemplated plea on the part of those involved in the Louisiana Quarry Company except that Reid was supposed to see Viosca on Wednesday, May 13th. (I learned after the proceedings that there had been one or more conferences held between the United States Attorney and Counsel for the defense extending over a considerable period of time. I also learned from Counsel for the defense that they had been here all day May 13th, in conference but I do not know that the United States Attorney was present with them on the 13th).

This afternoon about three o'clock, while I was in an important conference at Masonic Temple, Mr. Viosca called and said the pleas would be entered. I immediately went to Court and found Mr. Viosca explaining to Judge Foster briefly what the indictments charged. With respect to the liability of Beasley the Court said on account of the demise of Beasley he was not concerned with that tax liability as he assumed the Government could assert it against the estate and then asked who would pay the Quarry liability whereupon Attorney House representing Wilson stated that they would do so. The Court stated that it would assert a fine only for the corporation because it could not be given a jail sentence and since the individuals were not charged with any deficiency he would be very lenient with them. The proffer of a check on a Little Rock bank was made

but the Court declined it and asked if they could not secure the money by wire today and adjourned Court for that purpose.

I accompanied Mr. Viosca to his office and learned that pleas of nolo contendere had been entered and I asked him why straight pleas had not been required whereupon he said that Wilson would not agree to that and he understood that Senator Joe Robinson had made an urgent plea for Wilson in Washington and that he had been in communication last night with Assistant Attorney General Keenan who had said there was no objection to accepting a nolo contendere plea. I said, "What about Weiss?" He said that he would not agree to entering any kind of plea. He then said that he did not believe there was sufficient evidence against Weiss and that he would not try the case. I pointed out to him the damaging evidence, in particular that Weiss had told Beasley not to file any return and said if that showed anything at all it is that Seymour Weiss was responsible for having conspired to the end that Beasley would not only not report the Quarry graft but would not report any income of any kind. I then called attention to his financial transactions and the valuable other pieces of evidence. He then discussed making some kind of statement to the Court and getting rid of it immediately. I told him that it was his "little red wagon". He wanted to know what our Department thought about it and I told him that I would not only not speak for the department but not for myself either and that I would not keep silent if he made a statement that there was no evidence. General King then entered the room and Viosca asked him if he thought that Weiss could be convicted and he said no. (General King to my personal knowledge does not know what the evidence is save for what Nichols might say. Attorney Box told me that he has not discussed Schiff's testimony at all fully with King).

Court then announced its readiness to impose sentence and after the fines had been paid, namely \$1,000.00 as to the Quarry and \$100.00 each as to the three individuals, Mr. Viosca stated, and the Court reporter was taking it down, that he moved to dismiss as to Weiss as he found upon investigation that the Government could not show that Beasley had not kept for his own use all of the \$260,000 alleged in the indictment but instead an amount less than the \$84,000.00 paid to the Quarry and that Weiss might raise the defense that he did not think that this was income to Beasley, etc. The Court cut him short and said, "If you wish to dismiss the case the Court will interpose no objection."

After-wards in the hall and in his office Mr. Viosca began to cast doubt upon the strength and sufficiency of the evidence in the Mississippi Valley case. I replied that it was an outstanding case from a conspiracy standpoint and an abundance of evidence. He said, "I am going to get in touch with Wilkinson tomorrow morning and see what can be done."

A. D. Burford,
Special Agent in Charge.

ADB/mb

May 30, 1936

The Secretary having noticed shipments of gold coming from India to the United States, he discussed with Lochhead the possibility of purchasing such gold in India and holding it for ultimate resale instead of allowing these shipments to enter the United States.

After study of this situation, Lochhead advised the Secretary that it would be impossible for the Treasury to purchase this gold in India at a rate which would allow it to be landed in the United States at \$35.00 an ounce or less, because of the keen competition among the commercial banks for this business. In a great many cases they undertake the original transaction at a loss, being willing to speculate that rates would allow them to make a profit before the gold reached the United States. At the same time, Lochhead pointed out that there were considerable quantities of gold being shipped from Holland to the United States and there was a possibility that the Treasury could purchase some of this gold and hold it in Holland in the same manner as was now employed in the purchases of gold in England.

The Secretary requested Lochhead to discuss this matter further with Taylor and to place orders for the purchase of such gold if it was agreed that it would be feasible.

After consultation with the Federal Reserve Bank and the checking of the figures covering the cost of gold shipment accepted from Holland, it was determined that a price of \$34.77 per ounce could be paid for gold in Holland and still allow it to be landed in the United States at a total cost of \$35.00 per ounce. Accordingly, the Federal Reserve Bank was instructed, on May 28, to give an order to the Dutch Central Bank to purchase up to \$10,000,000 of gold at \$34.77 per ounce and hold any such gold purchased under earmark pending our instructions as to either resale or shipment to the United States.

It was understood that although the initial order was for \$10,000,000 that this order would be increased to \$25,000,000 if conditions warranted.

6104

Preliminary Estimate

Senate Finance Committee Proposal No. All

I. Tax Provisions

1. Retain present taxes on statutory net income as now defined.
2. Repeal exemption of dividends from normal tax on individuals.
3. Define adjusted net income as the statutory net income less ordinary corporation income taxes plus 90 percent of dividends received. Define undistributed adjusted net income as adjusted net income less the dividend credit, and, in the case of corporations with adjusted net incomes of less than \$15,000, a special credit of \$1,000. Impose a tax on undistributed adjusted net income equal to the sum of the following:
 - 0 on first 20 percent of the undistributed adjusted net income.
 - 20 percent of the amount of the undistributed adjusted net income which is in excess of 20 percent and not in excess of 40 percent of the adjusted net income.
 - 30 percent of the amount of the undistributed adjusted net income which is in excess of 40 percent of the adjusted net income.

II. Estimated Revenue, Calendar Year 1936

| | |
|--|-----------------|
| Gross estimated increase in revenue over present law | \$ 680 millions |
| Estimated reduction due to special credit given small corporations | 28 " |
| Estimated net increase in revenue | \$ 652 " |

May 20, 1936

Preliminary Estimate

Senate Finance Committee Proposal No. A12

I. Tax Provisions

1. Retain present taxes on statutory net income as now defined.
2. Repeal exemption of dividends from normal tax on individuals.
3. Define adjusted net income as the statutory net income less ordinary corporation income taxes plus 90 percent of dividends received. Define undistributed adjusted net income as adjusted net income less the dividend credit, and, in the case of corporations with adjusted net income less than \$15,000 a special credit of \$1,000. Impose a tax on undistributed adjusted net income equal to the sum of the following:

- 0 of the amount of the undistributed adjusted net income which is not in excess of 30 percent of the adjusted net income.
- 20 percent of the amount of the undistributed adjusted net income which is in excess of 30 percent and not in excess of 50 percent of the adjusted net income.
- 30 percent of the amount of the undistributed adjusted net income which is in excess of 50 percent of the adjusted net income.

II. Estimated Revenue, Calendar Year 1936

| | |
|--|--------------------|
| Estimated increase in revenue over present law | \$ 515 millions |
| Reduction due to special credit given small corporations | <u>27</u> millions |
| Estimated net increase in revenue | \$ 488 millions |

May 28, 1936

PRELIMINARY ESTIMATE

May 27.

Additional
revenue
(million dollars)

Additional
revenue
(million dollars)

1. Repeal capital stock and excess profits tax - \$ 168

2. Impose present corporate tax rate (12½ percent to 15 percent) on statutory net income as defined in present law, which includes 10 percent of inter-corporate dividends received. -

3. Define adjusted net income as the statutory net income less corporate income taxes plus 90 percent of dividends received. Define undistributed adjusted net income as adjusted net income less the dividend credit, less a special exemption of \$15,000 to all corporations. Impose a tax on undistributed adjusted net income equal to the sum of the following:

25 percent on the amount of the undistributed adjusted net income which is not in excess of 20 percent of the adjusted net income; 35 percent on the amount of the undistributed adjusted net income which is in excess of 20 percent and not in excess of 40 percent of the adjusted net income; and 45 percent of the amount of the undistributed adjusted net income which is in excess of 40 percent of the adjusted net income.

Yield of such tax on undistributed adjusted net income and of surtax on dividends to individuals. \$ 790

TOTAL ADDITIONAL REVENUE \$ 622

1. Retain capital stock and excess profits tax -

2. Impose present corporate tax rate (12½ percent to 15 percent) on statutory net income as defined in present law, which includes 10 percent of inter-corporate dividends received. -

3. Define adjusted net income as the statutory net income less corporation income taxes plus 90 percent of dividends received. Define undistributed adjusted net income as adjusted net income less the dividend credit, less a special exemption of \$15,000 to all corporations. Impose a tax on undistributed adjusted net income equal to the sum of the following:

15 percent on the amount of the undistributed adjusted net income which is not in excess of 20 percent of the adjusted net income; 25 percent on the amount of the undistributed adjusted net income which is in excess of 20 percent and not in excess of 40 percent of the adjusted net income; and 40 percent of the amount of the undistributed adjusted net income which is in excess of 40 percent of the adjusted net income.

Yield of such tax on undistributed adjusted net income and of surtax on dividends to individuals. \$ 630

TOTAL ADDITIONAL REVENUE \$ 630

If the percentage of intercorporate dividends now subject to corporate income tax be increased from 10 percent to 13-1/3 percent, the additional yield would be \$5 million. If from 10 percent to 16-2/3 percent, the additional yield would be \$10 million.

These estimates assume no changes in existing law other than those cited above and that the new bill will contain provisions which will prevent any avoidance of the above taxes.

May 27, 1936

264

May 20

Senate Finance Committee Proposal A-13

Additional revenue (million dollars)

Senate Finance Committee Proposal A-14

Additional revenue (million dollars)

1. Repeal capital stock and excess profits tax
2. Impose present corporate tax rate (12 $\frac{1}{2}$ percent to 15 percent) on statutory net income as defined in present law, which includes 10 percent of intercorporate dividends received
3. Define adjusted net income as the statutory net income less corporate income taxes plus 90 percent of dividends received. Define undistributed adjusted net income as adjusted net income less the dividend credit, less a special exemption of \$15,000 to all corporations. Impose a tax on undistributed adjusted net income equal to the sum of the following:

13 percent on the amount of the undistributed adjusted net income which is not in excess of 20 percent of the adjusted net income; 25 percent on the amount of the undistributed adjusted net income which is in excess of 20 percent and not in excess of 40 percent of the adjusted net income; and 40 percent of the amount of the undistributed adjusted net income which is in excess of 40 percent of the adjusted net income.

Yield of such tax on undistributed adjusted net income and of surtax on dividends to individuals. \$ 649

4. Remove exemption of dividends from individual normal tax \$ 144

TOTAL ADDITIONAL REVENUE \$ 625

1. Retain capital stock and excess profits tax
2. Impose present corporate tax rate (12 $\frac{1}{2}$ percent to 15 percent) on statutory net income as defined in present law, which includes 10 percent of intercorporate dividends received
3. Define adjusted net income as the statutory net income less corporation income taxes plus 90 percent of dividends received. Define undistributed adjusted net income as adjusted net income less the dividend credit, less a special exemption of \$15,000 to all corporations. Impose a tax on undistributed adjusted net income equal to the sum of the following:

8 percent on the amount of the undistributed adjusted net income which is not in excess of 20 percent of the adjusted net income; 22 percent on the amount of the undistributed adjusted net income which is in excess of 20 percent and not in excess of 40 percent of the adjusted net income; and 40 percent of the amount of the undistributed adjusted net income which is in excess of 40 percent of the adjusted net income.

Yield of such tax on undistributed adjusted net income and of surtax on dividends to individuals. \$ 494

4. Remove exemption of dividends from individual normal tax \$ 123

TOTAL ADDITIONAL REVENUE \$ 617

If the percentage of intercorporate dividends now subject to corporate income tax be increased from 10 percent to 13 $\frac{1}{3}$ percent, the additional yield would be \$5 million. If from 10 percent to 15 $\frac{2}{3}$ percent, the additional yield would be \$10 million.

These estimates assume no changes in existing law other than those cited above and that the new bill will contain provisions which will prevent any avoidance of the above taxes.

Tax Liability under each of the two Proposals Submitted May 27, 1936,
for a Corporation with Statutory Net Income of \$1,000,000
Which Retains all of its Earnings

I

Under the proposal which would (1) repeal the present capital stock and excess profits taxes; (2) retain the present ordinary corporation income tax rates; and (3) impose taxes on the undistributed adjusted net income, after a flat exemption of \$15,000 and a credit for dividends paid, equal to the sum of the following:

25 percent on the amount of the undistributed adjusted net income which is not in excess of 20 percent of the adjusted net income; 35 percent on the amount of the undistributed adjusted net income which is in excess of 20 percent and not in excess of 40 percent of the adjusted net income; and 45 percent of the amount of the undistributed adjusted net income which is in excess of 40 percent of the adjusted net income.

Tax Liability

| | |
|--|-------------------|
| Corporation income tax | \$ 149,440.00 |
| Tax on undistributed adjusted net income | <u>324,968.40</u> |
| Total | \$ 474,408.40 |

II

Under the proposal which would (1) retain the present corporation income taxes; and (2) impose taxes on the undistributed adjusted net income, after a flat exemption of \$15,000 and a credit for dividends paid, equal to the sum of the following:

15 percent on the amount of the undistributed adjusted net income which is not in excess of 20 percent of the adjusted net income; 25 percent on the amount of the undistributed adjusted net income which is in excess of 20 percent and not in excess of 40 percent of the adjusted net income; and 40 percent of the amount of the undistributed adjusted net income which is in excess of 40 percent of the adjusted net income.

Tax Liability

| | |
|--|-------------------|
| Capital stock tax | \$ 14,000.00 |
| Ordinary corporation income tax | 147,340.00 |
| Tax on undistributed adjusted net income | <u>262,371.20</u> |
| Total | \$ 423,711.20 |

The capital stock tax was computed by assuming a return of 10 percent on the capital, making the capital \$10,000,000. With a 10 percent rate of return on invested capital, the concern would be subject to no excess profits taxes.

May 28, 1936.

May 20, 1938

The following met with the Secretary at 12 o'clock today: Mr. Taylor, Mr. Helvering, Mr. Upham, Mr. Bell, Mr. Gaston, Mr. McLeod, Mr. Seltzer, Mr. Oliphant, Mr. McReynolds, Mr. Haas and Mr. Russell. It was Mr. McLeod's first appearance since he was in the Hospital and HM, Jr. greeted him cordially and asked if they had kept him up last night and McLeod said no; he had left at six o'clock.

HM, Jr. proposed cleaning up miscellaneous things first. He asked, "Where are we on the Guffey coal decision?" and Gaston handed him a memorandum from Guy Helvering (attached hereto). HM, Jr. said, "I saw that last night. Guy very carefully handed that to Mrs. Klotz." Oliphant explained that Internal Revenue had sent over a telegram for collectors to hold up collections. He said, "Guy and I agreed to hold it up after we checked with Justice, because in a day or two I expect they may be thinking about shoving through a very smart statute that these are separate." Helvering stated, "I looked up the 5 Justices who ruled it was a penalty and Justice Hughes concurred in that proposition, so there are 6 of them who thought it was a bounty and not a tax, so anything you do will not affect that."

Bell asked, "You mean he has collected \$650,000 and does not know what to do with it? Cover it into the Treasury!" When told that Mr. Helvering thinks it belongs back to the people, Bell said, "I would cover it back into the Treasury and let them fight for it. Never give up anything!" Helvering added, "We got \$11,000 on the assessment." Bell jokingly remarked, "Take that too!" HM, Jr. asked, "Why don't you and Dan flip a coin?" to which Mr. Bell smilingly replied, "Why flip a coin when you have it?" The Secretary said to make a note that on Friday he will again raise the question as to what Helvering is going to do with the \$650,000 of Guffey coal taxes.

HM, Jr. told the group that Wideman "walked in here unannounced about 20 minutes ago, very much disturbed and wanted to know who was going up tomorrow and represent the Treasury on this bill (H.R. 8940 - with reference to reorganization of corporations in bankruptcy) and I told him that between now and 12:15 I would call him, after talking to you, Herman. He wants somebody up there who is going

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to plead on Section 77-B. Who will be up there tomorrow?" Oliphant replied, "We are going up in full force and Hester is going over to see Wideman personally about it." HM, Jr. at this point telephoned to Wideman and gave him this information.

The Secretary said, "I have a lot of miscellaneous things before we get down to business. This is a memorandum from the President:

"The White House
May 19, 1936

MEMORANDUM FOR
THE SECRETARY OF THE TREASURY
THE ATTORNEY GENERAL
THE SECRETARY OF THE INTERIOR
THE ACTING DIRECTOR OF THE BUDGET

I have approved S. 1432 An Act to amend the "War Minerals Relief Statutes."

It is noted that the Department of the Interior files no objection to approval of the bill, that the Treasury Department does not believe approval would constitute a precedent, and that the Attorney General and Acting Director of the Budget recommend veto. Subsequently the Attorney General writes withdrawing his recommendation for veto and making no recommendations.

It is clear to me that it is contrary to public policy for the Government to undertake to pay interest on claims. Nevertheless, this particular bill does not, in my judgment, fall within this rule, for the reason that the interest to be paid was not interest on a claim against the Government, but was interest on money borrowed for a war purpose and, therefore, was an operating cost in the same sense that materials for buildings were an operating cost.

This distinction should be kept clearly in mind if legislation comes before us in the future.
F.D.R."

HM, Jr. inquired, "What's it all about, Dan?" Mr. Bell replied, "I don't know why the memo." McReynolds asked, "Do you know who wrote the memo?" and Mr. Bell answered, "No. I assume the President dictated it while a number of Congressmen and Senators were sitting at his desk and probably was an attempt to justify his approval of the bill, but in my memorandum I pointed out that he could not veto

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this bill on the ground that this was interest on a Government claim, but you can veto on the ground that it is another grab out of the Federal Treasury 'and I so recommend'. Why he sends a memo, I don't know. I fully agree with the memorandum." HM, Jr. asked "And who wrote that?" and Mr. Bell replied, "I did. I think Mr. Taylor signed it." There were bursts of laughter over this statement. HM, Jr. remarked facetiously, "I am going to begin to look into these things! Do you ever meet yourself coming home, Dan?" Mr. Bell then stated, "Mr. Collins went into it very carefully and that's a correct statement. It does not constitute a precedent." When Bell, in answer to HM, Jr.'s question as to whether the President had signed the bill, answered yes, HM, Jr. remarked "It is water over the dam -- a precedent over the dam," but Bell said, "No, it is not a precedent." The Secretary then asked, "Who gets this money," and Bell explained, "Different people who expanded their plants during the war. Secretary Lane went out and encouraged these people to expand their mineral plants and when the war suddenly stopped they found themselves with the greatly expanded plant beyond the needs of the industry, so they lost a lot of money, but they are in the same position as a lot of other people who acted patriotically and went out and expanded their plants and suddenly found the war had stopped."

HM, Jr. wanted to know how many dollars were involved in the bill and Mr. Bell answered, "One and a quarter millions; they have already been paid nine and a half millions." The Secretary then asked, "That's finished?" and Mr. Bell said yes.

The Secretary had one other thing to discuss. He said, "Whoever introduced and is following that thing about Admiral Hamlet's retirement, I would like to see that go through."

HM, Jr. then told the group that he had talked to Joe Robinson. He said, "Joe Robinson was all day yesterday getting me and did not get me and McIntyre said, 'You have to talk to him'. I finally got him at 8 o'clock this morning at his house. Joe said, 'I put through that Omnibus Liquor Bill yesterday' and I said, Swell! 'By the way,' Joe said, 'we missed each other all day yesterday. You know that inspector in my State? I want to get him a raise." McReynolds said, "I gave it to Harold this morning and told him to check back if he could recommend it." HM, Jr. remarked, "Of course, the bill and the raise have nothing to do with each other! I talked to the President and I thought he would drop out of bed; he thought it was so funny."

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Continuing, HM, Jr. said, "I want you, when you tell him you have given him the raise, that he ought to put through our reorganization bill." McReynolds remarked, "You see, he got the other bill through before he got the raise and he ought to give us another bill." Russell suggested giving him two raises for the tax bill.

The Secretary also told the group, "Robinson does not want us to take on the Stabilization Fund now. It is a bit dangerous. McNary said everybody was all right on the Stabilization except Vandenburg and I don't feel like going to Vandenburg and saying please don't. So Robinson says not to worry. We will all be here in January and get it through the first thing." Oliphant wanted to know about the silver tax and HM, Jr. said, "He's going to sound out some of the silver boys."

Turning to George Haas, HM, Jr. said, "You came in here with a worry. Spread it!" Haas had the following to say: "At the moment, on this program, we go up at 2 o'clock with some estimates. We have about 8 finished after a fashion. We could go up with them, but I think we are taking too much risk. They ought to go through my shop. The boys worked all night. But if we don't go up, Harrison may be somewhat unhappy. But my own opinion is we might as well face that situation rather than having to leave them something that there might be error in later on. So that's about how we are situated." HM, Jr. said, "I would like to hear a little discussion on this thing."

Helvering said, "Russell was up there this morning. I would like to ask him if he got anywhere this morning." Russell answered, "This morning, we took up a memorandum on windfall tax. When I left, they were discussing foreign tax-payers and one of the Senators asked Senator Harrison if they would take up the fiscal bill this afternoon. He said yes, and they are to meet this afternoon at 2 o'clock in the District Committee Room in the Capitol. That is Senator King's committee room."

Oliphant stated, "What the Committee is doing now is bringing up all sorts of possible schemes that now run into a dozen or more. You can think of a scheme in a couple of minutes and ask our shop to estimate it, and it takes time." HM, Jr. called of Mr. Helvering first after saying, "Let's just go around the table." Mr. Helvering's reaction was, "My theory about it, Mr. Secretary, is this: as long as they are just herding around

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and getting this estimate and that estimate and the other estimate, the boys getting up those estimates are just furnishing the rates they ask for and no recommendation of the Treasury at all, and Mr. Haas and myself or yourself first ought to approve any of these estimates as estimates for the tax bill; that we are standing firmly on the proposition that we have agreed to go along with them on a flat tax but that additional revenue has to be raised from the superimposing of a graduated distribution tax." And HM, Jr. added, "If we agreed to go along with them on the flat tax." Oliphant remarked, "We have said nothing about that." HM, Jr. explained, "In this room, though, we have. To quote Mr. Oliphant, 'we are going to reluctantly and gracefully yield'. But that does not get down to George's question. Should his men go up there with this stuff? I think we should decide it this way: Should we withhold it on the basis that we don't believe in the plan or should we withhold it because the figures are not sufficiently sure?" Haas agreed, saying "That's the question."

HM, Jr. inquired of Mr. Haas, "Have you any figures?" and Haas replied, "Yes, we have them, but they are all in that state. We have about eight sets of figures. The situation is this: the boys worked all night (four of them worked) and some have new innovations and they had to make a decision and we are not in agreement in our shop as to that. We have not had time to go over it. So I am quite fearful that after we have had the time to check them, we may change our minds. Even the boys who made the decision last night, because they were forced to make the decision, may change their minds." HM, Jr. wanted to know which Senators had asked for the material and Seltzer replied, "Harrison has asked for most of it. King is very anxious to get an easy one on flat corporation tax. Barkley and Connally asked for four."

Asked by the Secretary what he thought, Mr. Upham answered, "Oh, well, I think if it were my problem I would talk to Senator Harrison about it. The Committee has just about reached the point that they have to make a decision on the kind of tax bill they are going for and, of course, Seltzer more or less assured the Senator that he could have these estimates by this morning and they will be expecting them and if they don't get them it will be the Treasury holding up the Committee. I would be inclined to give estimates with reservations instead of not giving them any at all. We can explain that they are still not 100% sure, but the best we had."

The Secretary next asked McReynolds what he thought. His answer was, "It's pretty hard to decide. My personal judgment is for the kind of estimates they are getting and the kind of bills they are proposing that an estimate that stays within the definite range of guessing -- you are just estimating the best you can, as a preliminary estimate and if you so label it I don't personally see any objection to giving them to the committee in that form."

HM, Jr. expressed himself as follows: "There is no possibility of going down there and labeling it 'tentative estimate'. We have tried it over and over again. We had the same experience with the House committee. If anybody goes down there and says we tentatively estimate, they will finally hang it on you as your estimate. I think the answer is that I had better call Harrison. Otherwise he will just send word to me that the estimates have not been received." Helvering added, "You can't expect the boys to get up a dozen estimates because a little change in this and a little change in that might make a big difference in the tax. If they will settle down on two or three estimates that they are seriously considering as a committee ... " Mr. Morgenthau interrupted him to ask, "Don't you think I should call Pat?". Mr. Helvering replied, "Yes, I would explain that it is physically impossible."

At this point, HM, Jr. called Senator Harrison and the following is a record of their conversation:

HM, J.: Hello.

H.: Hello, Henry.

HM, Jr.: How are you?

H: Oh, fair.

HM, Jr: Well I - I (laughter) I sound - I feel about the way you sound. (Laughter)

H: What's that?

HM, Jr: I feel about the way you sound.

H: Yes.

HM,Jr.: Pat, I've got my gang here with me on this tax bill.

H.: Yes.

HM,Jr.: And - been going over - we've got about 8 different estimates that they've been working on.

H: Yes.

HM,Jr: Now the crowd that's doing the estimates work right straight through the night and they're still here and they're not in agreement after their estimates. Now what I'am afraid of and fearful is to send you up something as important as this and maybe I'll be out 150 million dollars.

H: Well, Henry, I think it ought to be passed on an approximate proposition. They can't be absolutely sure on it.

HM,Jr: No - but supposing we're out 150 million.

H: Oh, well, 150 million out if a big out.

HM,Jr: Yes.

H: That's a big out.

HM,Jr.: Yes.

H: But I think they ought to come up here at 2 o'clock and give us what they've got.

HM,Jr.: You do.

H: Of course I don't want to get a lot of estimates and different ideas on them but the - I figure they'd subject the Treasury to some criticism if they didn't come up here and give us some.

HM,Jr; Well, that's why I'm calling you.

H: Yes.

HM,Jr: And - well now could I do this. If our boys say now "we're not sure of these figures" if you'll - I don't mind.

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- H: Just tell them that you've got them up as best you could, it's a hurried job and it's - it looks like approximately this.
- HM,Jr: Well now, supposing after working all night again tonight they come up tomorrow morning and say "well now we're off 150 million on one of these".
- H: Well of course that's bad, Henry. Whenever they - an expert has to admit being wrong that much.
- HM,Jr: Yes.
- H: That's why I say it's best not to tie them down to exact amount but to say "it's approximately this". All we want is a rough proposition.
- HM,Jr: Well could they say, for instance that --
- H: What's that?
- HM,Jr: Could they say "Plan A produces between say 2 and 300 million?"
- H: Well that's a pretty wide breach you know. I'm just saying that they might criticize your Department up there.
- HM,Jr: If we didn't tell them?
- H: Because these newspaper fellows are just -- everybody has been waiting on these estimates.
- HM,Jr: I see.
- H: You see?
- HM,Jr: Yes.
- H: And I don't want them to get in on you up there.
- HM,Jr: No.
- H: And that's what they'll do.
- HM,Jr: I see.

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H: And they ought to say approximately this.

HM,Jr: Ah ha. Well they'll be up there. They won't put on a very good show though.

H: Well they'll just have to do the best they can.

HM,Jr: All right.

H: But that would be my idea about going around on the thing.

HM,Jr: Now let me ask you this. Have you got any guess as to when you think you're going to take a vote on it.

H: Well we may do it this afternoon. I was in hopes that I could get this thing out of the way.

HM,Jr: I see. Well the boys will be up there but they'll have to qualify their figures.

H: Well that's all right.

HM,Jr: Ah ha.

H: Give us the best you've got.

HM,Jr: All right, Pat.

H: Yes. All right, Henry.

HM,Jr.: Thank you.

The Secretary wanted to know who from the Treasury would go up on the Hill and Haas answered, "Seltzer is going up. But I suggest he take up the one that we are surest of." HM,Jr. asked Mr. Seltzer, "Are you timid about going up this afternoon," and he replied, "No." Asked by the Secretary if he thought any of the estimates could be off \$150,000,000, Seltzer answered, "I should be awfully surprised." "Do you feel you can go up and make a fairly decent presentation?" the Secretary asked him, and he replied, "I think I can qualify the figures as much as they need." HM,Jr. then told the group, "As Harrison talks, I don't think we can afford not to take the gamble. We

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can't be put in the position of holding up the bill."

Speaking to Seltzer, the Secretary said, "I hear that in your testimony you have been doing fine. You go up there and say that on these things we are not sure and there are some other things you have asked for and on those we are not sure at all. Is that what you are going to say?" Seltzer answered, "Yes; that's right." Continuing, HM, Jr. said, "And suppose they press you for the other material?" to which Seltzer replied, "I will tell them simply that we can't give them figures that we have not worked through."

Addressing the group, the Secretary said, "I have a tentative date for tonight which I can break for a tax bill. I will check in between 5 and 6 o'clock tonight and find out. If this things breaks and they do something today and you do need me, I am available tonight. McReynolds, I will call you up between 5 and 5:30 and by that time we should know."

Upham remarked, "One thing that may interest you and Mr. Oliphant is that Harrison read a letter from the Secretary of State transmitting a memorandum from the French Ambassador protesting against the rate of tax on foreign corporations and non-resident aliens. The Committee was not impressed with it." HM, Jr.'s reaction was, "But it isn't playing ball. Did they say anything about bringing champagne in cheaper?" Upham answered, "No, it did not mention that."

Upham also reported the following: "Turney presented some amendments on the windfall tax. Pat wanted to know what the estimated decrease in revenue on account of those amendments would be, but of course Turney had nothing to say about that, so there will be another little estimate."

HM, Jr. then told the group, "When I call up Mac between 5 and 5:30 -- I am going for my horseback ride -- somebody please tell Mac how the thing stands so Mac and I can decide whether I should come back tonight. But it may be like Saturday. I thought they would do something and get it out and maybe this afternoon they will come in with ten new ideas."



TREASURY DEPARTMENT

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WASHINGTON

OFFICE OF
COMMISSIONER OF INTERNAL REVENUE

ADDRESS REPLY TO
COMMISSIONER OF INTERNAL REVENUE
AND REFER TO

May 19, 1936

Memorandum for the Secretary:

In light of the decision of the Supreme Court holding the Bituminous Coal Conservation Act of 1935 invalid, I prepared a telegram addressed to the Collectors advising them to suspend the collection of taxes imposed under this Act, which telegram is now in Mr. Oliphant's office. Mr. Oliphant communicated with Justice, and the Solicitor General requested that the despatch of this telegram be postponed for a day or two.

After clearance with Justice, Collectors will be instructed, on behalf of taxpayers, to file blanket claims for abatement covering all outstanding assessments relating to this tax.

Collections up to May 1, 1936, amounted to \$674,883.49; this sum plus the collections in May are subject to refund. Following the usual procedure relating to refunds, taxpayers will file claims for the refunding of taxes paid.

The appropriation made for taxes erroneously and illegally collected covering the current fiscal year is sufficient to meet this additional expenditure. It will, therefore, not be necessary to ask for a deficiency appropriation.

Guy F. Helvering
Commissioner.

THE WHITE HOUSE

THE WHITE HOUSE
WASHINGTON

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May 19, 1936.

MEMORANDUM FOR

THE SECRETARY OF THE TREASURY
THE ATTORNEY GENERAL
THE SECRETARY OF THE INTERIOR
THE ACTING DIRECTOR OF THE BUDGET

I have approved S. 1432 An Act to amendthe "War Minerals Relief Statutes."

It is noted that the Department of the Interior files no objection to approval of the bill, that the Treasury Department does not believe approval would constitute a precedent, and that the Attorney General and Acting Director of the Budget recommend veto. Subsequently the Attorney General writes withdrawing his recommendation for veto and making no recommendations.

It is clear to me that it is contrary to public policy for the Government to undertake to pay interest on claims. Nevertheless, this particular bill does not, in my judgment, fall within this rule, for the reason that the interest to be paid was not interest on a claim against the Government, but was interest on money borrowed for a war purpose and, therefore, was an operating cost in the

THE PRESIDENT OF THE UNITED STATES
THE SECRETARY OF THE TREASURY

MEMORANDUM FOR

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same sense that materials for buildings were an operating cost.

This distinction should be kept clearly in mind if similar legislation comes before us in the future.

F. D. R.