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January 16, 1940

3:30 pm

Present:

Mr. Gaston  
Dr. White  
Mr. Cotton

HM, Jr: Every time I see Traphagen, I let Welles know everything that we have done. He's supposed to let me know. Welles did not know that Herbert Feis had been talking to Francis White, and the whole purpose of this thing was to cut off communication between State and Treasury. What business is it of Herbert Feis to talk to Francis White? The attitude of the Council is, well, at last Mr. Morgenthau is trying to do something -- and therefore they don't want to see me double-crossed.

(At this point, HM, Jr read the two conversations with Mr. Welles dated January 15th.)

At first Welles says he does not know, and only the other day I caught Welles twice red-handed lying.

Dr. White: Feis could take the position that he did inform Welles and in a memorandum that he did mention casually the Brazilian.

HM, Jr: I say Feis has absolutely no business to talk to the Bondholders Committee when it was agreed I was the sole person to talk to Traphagen.

Dr. White: Can you get the minutes of the last meeting that Feis talked orally at that meeting about having talked with Francis White? It was decided to take up the Brazilian thing in the next ten days -- Welles, Jones and yourself.

(Mr. Cotton joined the group at this point.)

HM, Jr: Jo, the reason I sent for you -- today it was brought to my attention that Herbert Feis went up to

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New York and had a discussion with Francis White on the Colombian debt and on the Brazilian situation, and the part that bothered me was that he was reported as having advised Francis White contrary to what we were trying to do.

Now, in this discussion which took place (referring to conversations with Welles 1-15-40) my first conversation, asking that a memorandum be prepared by Herbert Feis for me covering this thing, Welles first saying when I told him he knew nothing about it. He called me back in a few minutes and said he did know about it, but there was no discussion taking place, he claimed, at any time except in a casual way, but he said, "Herbert Feis reported to Cotton of his meeting with Francis White."

Mr. Cotton: This is Colombia, and not Brazil?

HM, Jr: This is Brazil. A meeting took place on the 30th of December in New York between Feis and Francis White and when I asked for a copy of his conversation, Welles saw Feis and Feis is reported to have said that he had informed the Board.

Mr. Cotton: No discussion when he has been over here on Brazil except a sort of background way, but has never told me anything about a New York conference.

HM, Jr: Let me put it another way -- if Feis had told you while the three of us were sitting here -- you and I take the responsibility for contacting Traphagen -- you remember Feis saying he has been up in New York to see Francis White?

Mr. Cotton: I am racking my brains, but I have absolutely no recollection.

Dr. White: You were surprised by the information he had seen Francis White?

Mr. Cotton: I was very amazed.

Dr. White: In the minutes of that meeting he claims to have mentioned that he had seen White. Collado claims he has done so.

HM, Jr: I know I was double-crossed on Brazil. Now

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they want to go into the same thing and they have cooked this whole thing up on Brazil how they are going to handle it leaving the Treasury out of it, because I know what is in the memorandum Francis White wrote to another Councilman and I take it the Council is so pleased with what we have done that they don't want me to be double-crossed. I have not got this in my hand, but I can get it if necessary and I take it the Council is so pleased with what we have been doing, you (Cotton) and I, that they don't want to see me double-crossed; therefore, they go out of their way to tell me this. Then, when I ask Welles, first he says he did not know Feis had been up there; subsequently, he said he did. In this memorandum, not only is it unheard of that Feis should be in touch with the Council -- that's our end of it, just as I started the negotiations with the Colombians. And Welles has played fair with me. Now they want me to do the Brazil thing and I have to decide one of two things, either I go to the President and tell him this whole story and I don't know whether it's Feis or Welles or both who have double-crossed me, or I will say I will do it if you kick the State Department out, which is impossible, and so, Mr. President, I can't do it.

Dr. White: Supposing he says we are going to discuss the Brazilian thing; that's the next thing on our agenda -- you are in it with both feet.

Mr. Cotton: I can give you a perfectly plain answer. I am surprised to hear it and unless he said it in a group he never told me and I cannot recollect anything like that in the group, but he never told me personally of his contact with White.

HM, Jr.: I am not as dumb as some people think I am and maybe Feis is the goat on this thing, and certainly from the way it looks, certainly when I called up Welles, first he did not know anything about this. As I say, why I am making so much of it is I don't want to get into a lot of useless wrangles and burn up myself where it is impossible. I am going to confine myself to where I have a 60% chance of being successful for my country and not where I am double-crossed and this memorandum shows where Feis went to the Council on December 21st to get them to send their own representative down there and we would be completely out.

Mr. Cotton: I think Feis, when he was over here in

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one of the meetings expressed the idea that someone should be sent down from the Council.

Dr. White: I think you also said, Mr. Secretary, you thought that would be a good idea.

HM, Jr: My position is this: if I am to contact the Council through Traphagen, then nobody has any right to go and see the Council without first communicating with me.

Dr. White: He might have taken your comment coupled with his as acquiescence on your part that he make that arrangement. I frankly confess you don't have a strong case.

Mr. Cotton: I am a little afraid I remember Feis saying here "We have urged them to send someone".

HM, Jr: I am not going to talk to Feis, because if I did I would lose my temper. That's why I am going to let Herbert talk to them, so when he has all the facts he can send for him and talk to him.

Mr. Cotton: I venture the opinion you ought to go easy, because this Colombian thing is right on the point we may get somewhere. When I had opportunity I wanted to tell you Mr. Jones also called upon Traphagen in New York.

HM, Jr: Jones told me he was going to talk to him about this plan.

Mr. Cotton: As a matter of fact, I talked yesterday to Jaramillo, who is very anxious for settlement, and I think this thing may be able to be bridged.

HM, Jr: I am not going to talk to Feis, because I have been sore for two years and knowing him personally and being his superior official, I am not going to take advantage of my official position.

Dr. White: I think you should keep your suspicions and wait until you have a clearer case. I am not convinced you can make the kind of a case you want to the President.

HM, Jr: Did you see the by-play when he came in 20 minutes late -- Welles? I will tell you what he said.

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Welles comes in 20 minutes late and said, "Did you get my message that I would be 30 minutes late?" I said "No. Who phoned me?" He said, "Herbert Feis." I turned to Feis and said, "Who did you phone it to?" "I can't remember," and I said, "What you mean is you forgot to phone." Why lit to me. It's not important. If he had said "I am busy with Mr. Hull on trade treaties and stayed longer than I wanted," I would say all right, but knowing he had an appointment at ten o'clock .....

Mr. Cotton: I think you have ample ground for irritation, but I am afraid it's one of those things that Brazil was not actually on the map the same way Colombia was.

HM, Jr: They mentioned we ought to get busy on the Brazil thing and not wait until the Colombian thing was finished, but to the best of my recollection nothing was mentioned that Feis or anybody would contact Francis White.

Dr. White: I don't remember White's name, but ....

HM, Jr: You have the picture, Herbert, and as my contact man with the State Department I would like you to send for Herbert Feis.

Mr. Gaston: About his record on this thing.

HM, Jr: Yes.

Mr. Cotton: Of course, the State Department is very anxious to spike Mr. Noble and his plans.

Dr. White: Noble calls Welles and his calls are ignored.

Mr. Cotton: Noble has cleared it with a lot of people in New York. He has talked to numerous people who say it is an idea worth going into. He has the United States Steel on the point of approving a report of their special experts who went down. It is something to think about.

HM, Jr: We know how they feel about Ed Noble of Commerce, but you don't know how they feel about me and I think they feel just the same about me as they do Ed Noble.

Dr. White: You may be right 100% and you have plenty of right to be annoyed, but before you move in

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that direction, give them a little more rope. I don't think there is a case yet.

HM, Jr: Let me put this on the plane it should be lifted on, and that is I think it is in the interest of the American people that we settle these debts. Now, my objective is to settle debts. If, having to do it I have to step on a couple of people, I am willing to step, but I am more interested in getting the debt settled than I am in stepping on people. I try to keep my eye on the bull's-eye. May be a lot of flies or mosquitoes to distract me. But these cross-currents are very disconcerting, just the same as a mosquito bite is. This thing never happens in the Treasury, but it happens all the time on the outside.

oOo-oOo

Prepared by: Mr. Murphy  
Mr. Brown  
Mr. Tickton  
7 Mr. Haas

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE January 15, 1940,

TO Secretary Morgenthau

FROM Mr. Haas

Subject: Should the Terms of Issuance of United States Savings Bonds be Changed? -- A Discussion of the Considerations Involved and of Alternative Proposals

PLAN OF MEMORANDUM

This memorandum discusses the general subject of savings bonds under the following six subtopics:

- I. How Does the Rate of Interest on Savings Bonds Compare with Other Rates Available on Small Savings?
- II. Who Are the Principal Holders of United States Savings Bonds?
- III. How Does the Rate of Interest on Savings Bonds Compare with that on Other United States Securities?
- IV. What Might Be Done to Lessen the Availability or Attractiveness of Savings Bonds to Institutions and to the More Prosperous Individuals?
- V. Proposals to Reduce the Intermediate or Maturity Return on Savings Bonds.
- VI. General Considerations.

I. How Does the Rate of Interest on Savings Bonds Compare with Other Rates Available on Small Savings?

The rates of interest available to the small saver at the present time are much higher than those available to the large saver. This is due principally to the "regressive" interest schedules by which many classes of private financial institutions now pay higher rates on small accounts than on large ones, or decline altogether to accept and pay interest on accounts of more than a limited amount. From the point of view of the small saver, therefore, the rate of return on savings bonds -- now 2.90 percent if held to maturity -- must be compared with the relatively high rates at which limited sums of money may be invested rather than with the much lower return which can be obtained on larger sums.

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The following data will give some idea of the nature of the investment opportunities competitive with savings bonds which are open to the small investor.

A Postal Savings account is probably the investment most nearly comparable to savings bonds from the viewpoint of the small saver. Such accounts are limited to \$2,500 for any one individual and pay a return of 2 percent, which rate has been unchanged since the inception of the System in 1910. It should be noted, however, that this rate is obtainable for a period as short as three months, whereas savings bonds must be held 2-1/2 years before they yield a greater return. This comment with respect to period holds in only somewhat smaller degree for the other alternative forms of investment about to be discussed, for in each of them the maximum return can be obtained over a period of not more than a year.

The interest on savings accounts in insured commercial banks is restricted by Federal regulation to a maximum of 2-1/2 percent. This return is very difficult to get, however. In Washington, for example, the maximum rate permitted by the Clearing House Association is 2 percent on the first \$2,500 of savings deposits and 1 percent on the balance of the account. In practice, however, most local banks pay 2 percent on the first \$1,000 and 1 percent on the balance, while some have a further downward graduation in rate, or will not accept "investment-type" deposits at all.

According to the National Association of Mutual Savings Banks, the average rate of interest "per deposit" paid during the first six months of 1939 by all mutual savings banks in the United States was 2.17 percent. Most mutual savings banks place a limit on the amount of deposits which they will accept from any one individual.

There are no immediately available over-all figures on the average dividend return paid on share accounts in building and loan associations. The average rate obtained by the Home Owners' Loan Corporation on its investment in these accounts is probably representative, however. In the six-months period ended July 31, 1939, this average return was 3.48 percent. Such accounts, it should be noted, however, are substantially inferior with respect to liquidity to any of the other forms of investment here discussed.

## II. Who Are the Principal Holders of United States Savings Bonds?

The greater portion of the outstanding amount of United States savings bonds is held by rather well-to-do persons. Our evidence on this point must unfortunately be indirect, since there are no tabulations available of the amount of bonds outstanding classified by the size of individual holdings. The data which are available, however, seem adequate to establish the point. These data are as follows:

### (1) Limit Sales

Commencing on January 1, 1939, the Division of Loans and Currency has kept a record of all persons whose purchases of savings bonds during a single calendar year have totaled the legal limit of \$10,000. During the first seven months of 1939, the total audited sales of savings bonds (maturity value) amounted to \$699.6 millions, of which \$312.0 millions, or 45 percent, was purchased by the 31,200 persons who bought the legal limit. This would indicate a very high concentration of these securities in the hands of the well-to-do.

### (2) Sales by Denominations

Data on the sales of United States savings bonds by denominations are available from the commencement of their sale on March 1, 1935 through October 31, 1939. Over this period, the percentage distribution of sales, by denominations, in terms of either face amount sold or cash received has been as follows:\*

Denomination	:	Percent of
	:	total sales
\$ 25		2.2
50		3.3
100		11.0
500		15.9
1,000		67.6

\* The distribution of sales by pieces naturally shows an entirely different picture, but one of very limited significance. Such a distribution, covering the same period as that in the table in the text, is as follows:

Denomination	:	Percent of
	:	total sales
\$ 25		24.4
50		18.0
100		30.2
500		8.8
1,000		18.6

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When broken down by fiscal years, the distribution of the volume of sales by denominations shows a moderate trend toward the larger denominations. The proportion of \$1,000 bonds rose from 64 percent in the fiscal year 1936 (the first complete year of sale) to 71 percent in the fiscal year 1939. The proportion of \$500 bond sales declined, however, so that the proportion of sales of \$1,000 and \$500 bonds combined rose only from 84 percent to 85 percent between the fiscal years 1936 and 1939.\*

It should be noted, of course, that the figures on sales by denomination have only a limited significance. Since \$1,000 is the largest denomination available, limit purchasers must buy at least ten bonds and, in practice, some of them take part of their \$10,000 in bonds of denominations smaller than \$1,000. Some purchasers of the \$1,000 denomination, on the other hand, may buy only a single bond.

The significance of the classification by denomination is further impaired by the large number of purchasers who buy their bonds on the "regular monthly purchase plan," thereby often acquiring a large aggregate amount of the bonds all in relatively small denominations.

Despite all of these qualifications, however, the breakdown by denomination provides some measure of the lower limit to the possible dispersion of the ownership of the bonds, and indicates that most of them are held by the more prosperous section of the population.

### (3) Sales to Other Than Natural Persons

About 15 percent of the aggregate amount of savings bonds sold between March 1, 1935 and October 31, 1939 were sold to other than natural persons. Of this amount, about 9 percent was purchased by banks and trust companies, and 6 percent by other corporations and associations. There has been very little change in recent years in the proportions so sold.

### (4) General Observation

The popularity of savings bonds with well-to-do investors may be seen from the increasing frequency with which they are recommended by investment counselors and others having to do with the solution of investors' problems.

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\* Only figures for complete twelve-month periods are comparable due to a strong seasonal factor.

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A cross section of such recommendations is provided by the answers to Barron's recent contest on the subject of investing \$100,000 for a young widow with two children. Fifty-five per cent of the 801 entries which were graded "fair" or better by the judges included United States savings bonds in their programs. In 106 programs, this was the only type of bond recommended, while in a few cases it was planned that the entire fund would ultimately be invested in this medium. "There is no doubt", says Barron's, "that 'baby bonds' must be awarded the distinction of being the most popular single security of any kind in this contest."

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III. How Does the Rate of Interest on Savings Bonds Compare with that on Other United States Securities?

The interest return on United States savings bonds is much higher than that on any other class of United States security. The return on a savings bond, if held to final maturity ten years hence, is 2.90 percent. This compares with a return of only 1.75 percent on the 3-1/8's of December 15, 1949-52, the general market issue most nearly comparable to savings bonds with respect to first call date, and with a return of only 2.34 percent on the 2-3/4's of 1960-65, the longest and highest yield issue of Treasury bonds now outstanding.

If held only one year (the minimum period necessary to receive any return at all), savings bonds give a net return of 1.33 percent, which is greater than that on any Treasury bond first callable within the next 6-1/2 years. If held only three years, savings bonds give a net return of 2.16 percent, which is greater than that now obtainable on any Treasury bond maturing or callable earlier than the 2-7/8's of 1955-60.

Furthermore, the holders of savings bonds, while securing these rates, have perfectly liquid instruments, which they may cash at any time (after sixty days from date of issuance) when it appears to be to their advantage and to the Government's disadvantage to do so -- i.e., in the event of a future increase in interest rates to a level higher than that now paid by savings bonds. The value of this privilege of receiving a long-term rate on a short-term instrument is difficult to measure quantitatively, but would make savings bonds far more attractive than instruments payable at fixed dates or at the option of the Treasury, even if their computed yields to final maturity and to intermediate redemption dates were the same as those on the open market obligations now outstanding.

The return on savings bonds has remained unchanged ever since they were first placed on sale on March 1, 1935. Even at that time savings bonds were somewhat more attractively priced than other classes of Government securities, but the major portion of the present disparity has resulted from the decline in the yields of open market securities since that time. This is shown in the accompanying chart, which indicates that a maturity yield of about 2 percent for savings bonds would bear about the same relationship to the now prevailing level of open market yields on Treasury bonds as the rate of 2.90 percent did when they were first placed on sale five years ago.

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IV. What Might Be Done to Lessen the Availability or Attractiveness of Savings Bonds to Institutions and to the More Prosperous Individuals?

A number of devices suggest themselves by which the availability or attractiveness of savings bonds might be restricted principally to the lower-income classes. The most promising of these devices are as follows:

(1) Limit Sale to Natural Persons

An obvious device would be the limitation of the sale of savings bonds to natural persons. A somewhat less rigorous form of this restriction would permit such sales also to be made to non-profit organizations but would bar them to corporations organized for profit.

(2) Reduction in the Amount of the Bonds of Any One Series Permitted to be Held by Any One Person

At the present time any one person is permitted to hold up to \$10,000 maturity value of savings bonds issued in any one calendar year. This permits a single individual to hold as much as \$100,000 maturity value of bonds if purchased at the rate of \$10,000 a year for ten years.

The limit on the amount of savings bonds permitted to be acquired in any one year might be reduced to as low as \$2,000 or even \$1,000 without materially impairing the availability of the bonds to the lower-income classes. It has been noted previously that the maximum amount of Postal Savings deposits permitted to be held by any one person is only \$2,500, and even a \$1,000 annual limit on savings bond purchases would permit a total holding by a single individual of four times the amount of the statutory limitation on Postal Savings deposits.

(3) Reduction in the Total Holdings (Irrespective of Series) of Savings Bonds Permitted to be Held by Any One Person

The limit on the amount of savings bonds permitted to be held by any one person might be expressed in terms of total amount held rather than in that of bonds purchased in a single year. Any bonds already held in excess of such requirement would, of course, have to be excepted. If the limit were to be set in this way it might very well be kept at \$10,000. A limit expressed in this way might effect a more drastic limitation

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of sales with a smaller apparent break with the past than a limit expressed in terms of annual amounts. It would also be somewhat more rapid in its effect since it would immediately exclude from further purchases all those institutions and well-to-do persons already holding amounts in excess of the newly-established limit.

(4) Limitation of Holdings Permitted to a Single Family

At the present time a family consisting of, say, a man and wife and three children may acquire up to \$50,000 (maturity value) of savings bonds in a single year and up to \$500,000 in all. There is evidence that this type of purchase is actually occurring in some cases. A number of the contributors to the Barron's contest, previously referred to, suggested that the widow with two small children whose investment problem was the subject of the contest should forthwith purchase \$30,000 maturity value of savings bonds, \$10,000 for herself and \$10,000 for each child.

Multiple purchases of this type might be cut down by expressing the limitation in terms of family holdings rather than in those of a single individual. Such a course is open to substantial objection, however, since it would really discriminate against members of families as compared with unattached persons. For this reason one of the other forms of limitation already suggested would probably be preferable if limitation of some type seems the best course.

(5) Elimination of Tax-exemption

Savings bonds at the present time have the same tax-exemption features as Treasury bonds. This includes exemption from all Federal, State and local taxes except surtaxes and the estate, inheritance and gift taxes. The Second Liberty Bond Act specifies, furthermore, that \$5,000 principal amount of securities falling in this category shall be exempt from surtaxes also. The Bureau of Internal Revenue has held that the particular bonds with respect to which this exemption is claimed may be specified each year by the taxpayer and in the case of savings bonds shall be taken at their original issue price. This means, for taxpayers reporting on a cash basis, that a total of \$50,000 original issue value, or \$66,667 maturity value of savings bonds may be held completely tax free -- the \$5,000 (issue value) of bonds maturing in each year being designated in that particular year for the complete tax-exemption privilege.

Secretary Morgenthau - 9

Such tax-exemption is clearly of value only to quite well-to-do persons and is, consequently, in the nature of a special inducement to the purchase of the bonds on the part of the higher income classes, while contributing little or nothing to their attractiveness to small investors. It seems, therefore, that exemption from the income tax might very well be completely abolished with respect to savings bonds. If this suggestion appears too drastic, however, an intermediate remedial step might be the removal of savings bonds from the class of securities with respect to which \$5,000 principal amount may be specially designated by the holder each year for complete tax-exemption.

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V. Proposals to Reduce the Intermediate or Maturity  
Return on Savings Bonds

Two types of proposals for reducing the rate of return upon savings bonds might be considered. The first and less drastic type would merely reduce the return on the bonds if held for less than the full ten-year period; the second and more drastic type would reduce the return even if held until final maturity.

There would seem to be special justification for reducing the return on savings bonds if not held until final maturity. The disparity between the rate of return on savings bonds and that on open-market obligations is greater for intermediate periods than for the full ten years. Furthermore, it may be argued that intermediate redemption should be considered as a special privilege which should be accorded to the holders of the bonds only at some sacrifice below the standard rate of return to maturity. If such a reduction of intermediate redemption values should make savings bonds somewhat less attractive to persons who do not contemplate holding them until final maturity, this would seem to be a positive advantage.

Consideration should be given in this connection to the introduction of a special "maturity bonus" in the form of an abnormally large step-up in redemption value during the final six-month period. A precedent for this may be found in the case of War Savings Stamps where 29 cents out of the total enhancement in value of 88 cents (on a \$5 stamp) distributed over a period of five years occurred in the final month.

The attached two tables present various data concerning two plans which might be used should it be considered desirable to reduce the rate on savings bonds. The first plan reduces intermediate yields but maintains the present maturity yield unchanged. The second plan reduces the intermediate yields and also reduces the yield to maturity from 2.90 percent to 2.24 percent. The latter figure is about one-fourth of one percent higher relative to the present market yields of Treasury bonds than the 2.90 percent rate was at the time when the sale of savings bonds was first inaugurated five years ago. The reduction in final maturity yield in the second plan is achieved by increasing the original issue price from \$75 to \$80 per \$100 of maturity value. All step-ups in both plans are in even multiples of 50 cents.

Both plans provide a substantial "maturity bonus" although a much less drastic one than that which was provided by War Savings Stamps. In the case of the first plan (the one reducing

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intermediate yields only), this maturity bonus takes the form of a step-up of  $\$5$  in the final six-month period. In the second plan (the one reducing maturity as well as intermediate yields), the step-up in the final six-month period is  $\$4$ . In both cases, the step-up in the final six-month period is equal to 20 percent of the total return paid for the full ten years.

In connection with the matter of a maturity bonus, attention is especially directed to the section of Table II showing the yield on savings bonds "if held to maturity" from any intermediate date. This return measures the incentive which is offered to holders of the bonds to hold their securities through to final maturity even in the face of unfavorable intermediate developments -- such, for example, as a rise in the rate of interest. Under the present plan providing a 2.90 percent over-all yield this figure reaches a maximum of only 4.31 percent at the end of the fourteenth semi-annual period and thereafter falls back gradually to 4.08 percent at the end of the nineteenth period. In the first of the proposed plans, on the other hand -- the one reducing intermediate yields only -- this figure rises continuously during the entire life of the bond, exceeding 10 percent at the end of the nineteenth semi-annual period. In the second plan -- the one in which the over-all yield is reduced to 2.24 percent -- the residual yield to maturity also rises continuously, exceeding 3 percent at the end of the eighth semi-annual period, 4 percent at the end of the fifteenth period, and 8 percent at the end of the nineteenth period.

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## VI. General Considerations

### A. Interrelationship of Different Types of Changes

The two classes of suggestions just discussed for altering the terms of issuance of United States savings bonds -- suggestions for making them less available or attractive to the well-to-do and suggestions for reducing their interest return -- cannot be considered in isolation. If the sale of the bonds is to be limited principally to bona fide small savers, then a rather high rate of return may be necessary to maintain their attractiveness to such persons in competition with the rates paid on small savings by private financial institutions. The payment of a relatively high rate, furthermore, may be amply justified by the large number of persons to whom the purchase of savings bonds gives a direct interest in the financial stability of the Government. If, on the other hand, it is intended permanently that a large proportion of the bonds should be sold to the well-to-do, then considerations of fiscal economy would seem to indicate that the rate paid on them should not be substantially higher than that at which the same amount of money could be borrowed elsewhere.

Changes in the direction of making the bonds less available or attractive to the well-to-do would probably have a much more drastic effect upon their current sales volume than would reductions in the interest return. For example, the proposal limiting the amount of bonds which might be purchased by any one person in any single calendar year to \$2,000 would doubtless cut the current sales volume drastically, while that for reducing the interest return to 2.24 percent would effect a much smaller reduction in sales volume. It should be noted further that, whereas the reduction in sales volume which would be brought about by a direct limitation of individual purchases would come almost entirely at the top among the more prosperous buyers, a limitation effected by a reduction in the rate of interest would probably cut sales the most among the poorer classes to whom the present return does not seem high, and who have better alternative opportunities for the investment of their small savings.

### B. Policy With Respect to Changes in Rate.

Finally, if a large proportion of savings bonds are going to continue to be purchased by the well-to-do, attention is directed to the desirability of fairly frequent changes in the interest return offered on such bonds. Aside from its obvious fiscal economy, two important considerations favor such a policy.

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(1) It would prevent the building up of an apparent vested interest in the rate of return being offered on savings bonds at any given time. There can be no doubt that many people now believe that they can formulate a scheme for a lifetime of savings on the basis of the return now paid on such bonds. This is very undesirable from the standpoint of the flexibility of the Treasury's operations. Even if frequent changes in the rate of return should serve no other purpose than to dispel this illusion of continuity, they might be well worth while.

(2) If the rate were changed fairly frequently, each change would have less significance. It is much the same as the "fixed portfolio" versus the "flexible portfolio" arguments with respect to the Federal Reserve System's holdings of Governments. When nothing has happened for a long time, anything is news. Furthermore, if changes in the rate of return on the bonds were expected to be made from time to time, then any change which might prove ill-advised could be corrected in the usual course. When changes are infrequent, however, a single, ill-timed change might become a source of continued embarrassment.

If the sale of savings bonds should be limited for the most part to the lower income classes, the above considerations would lose much of their force, although a great deal could still be said in favor of some degree of flexibility in rate.

Attachments

Table I  
United States Savings Bonds  
Redemption Values and Yields During Period Held

Number of Periods Held (Semiannual)	Redemption Values			Yield During Period Held		
	Present Plan	Plan Reducing Intermediate Yields	Plan Reducing Intermediate and Final Yields	Present Plan	Plan Reducing Intermediate Yields	Plan Reducing Intermediate and Final Yields
1	\$ 75.00	\$ 75.00	\$ 80.00	0.00%	0.00%	0.00%
2	76.00	75.50	80.50	1.33	0.67	0.62
3	77.00	76.00	81.00	1.76	0.88	0.83
4	78.00	76.50	81.50	1.97	0.99	0.93
5	79.00	77.00	82.00	2.09	1.06	0.99
6	80.00	78.00	82.50	2.16	1.31	1.03
7	81.00	79.00	83.00	2.21	1.49	1.05
8	82.00	80.00	83.50	2.24	1.62	1.07
9	83.00	81.00	84.00	2.26	1.72	1.09
10	84.00	82.00	85.00	2.28	1.79	1.22
11	85.00	83.00	86.00	2.29	1.85	1.32
12	86.00	84.00	87.00	2.29	1.90	1.40
13	87.00	85.00	88.00	2.30	1.93	1.47
14	88.00	86.00	89.00	2.30	1.96	1.53
15	90.00	87.50	90.00	2.45	2.07	1.58
16	92.00	89.00	91.50	2.57	2.15	1.69
17	94.00	91.00	93.00	2.67	2.29	1.78
18	96.00	93.00	94.50	2.76	2.40	1.86
19	98.00	95.00	96.00	2.84	2.50	1.93
20	100.00	100.00	100.00	2.90	2.90	2.24

Treasury Department, Division of Research and Statistics.

January 4, 1939.

Yields are shown as nominal rates compounded semiannually.

Table II

United States Savings Bonds  
Yield During Succeeding Periods

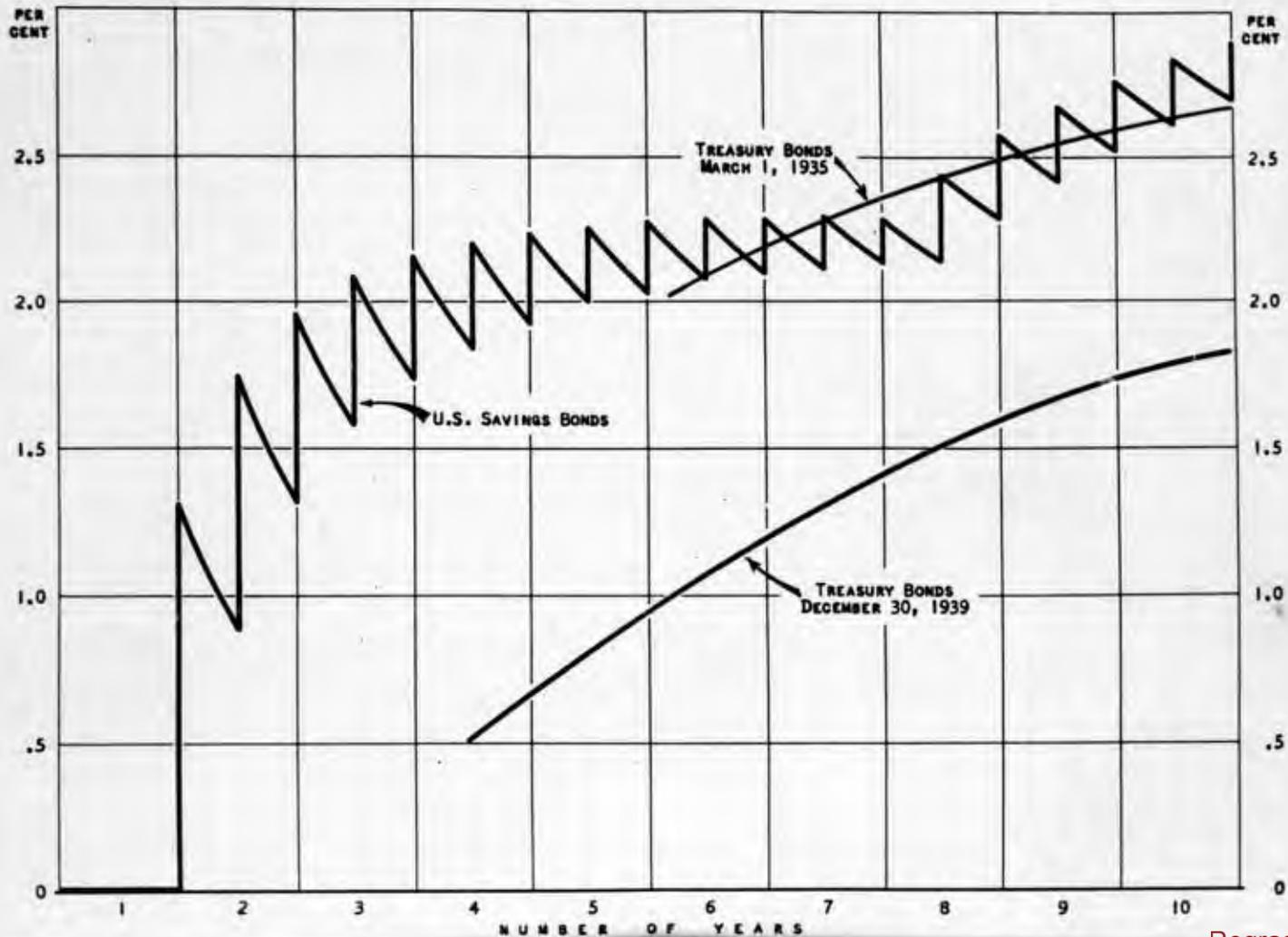
Number of Periods Held (Semiannual)	If Held One Additional Period			If Held to Maturity		
	Present Plan	Plan Reducing: Intermediate Yields	Plan Reducing: Intermediate and Final Yields	Present Plan	Plan Reducing: Intermediate Yields	Plan Reducing Intermediate and Final Yields
1	2.67%	1.33%	1.25%	3.05%	3.05%	2.36%
2	2.63	1.32	1.24	3.07	3.15	2.42
3	2.60	1.32	1.23	3.10	3.25	2.49
4	2.56	1.31	1.23	3.13	3.38	2.57
5	2.53	2.60	1.22	3.17	3.52	2.66
6	2.50	2.56	1.21	3.21	3.58	2.77
7	2.47	2.53	1.20	3.27	3.66	2.89
8	2.44	2.50	1.20	3.34	3.75	3.03
9	2.41	2.47	2.38	3.42	3.87	3.20
10	2.38	2.44	2.35	3.52	4.01	3.28
11	2.35	2.41	2.33	3.64	4.18	3.38
12	2.33	2.38	2.30	3.81	4.41	3.51
13	2.30	2.35	2.27	4.02	4.70	3.69
14	4.55	3.49	2.25	4.31	5.09	3.92
15	4.44	3.43	3.33	4.26	5.41	4.26
16	4.35	4.49	3.28	4.21	5.91	4.49
17	4.26	4.40	3.23	4.17	6.39	4.90
18	4.16	4.30	3.18	4.12	7.39	5.74
19	4.08	10.53	8.33	4.08	10.53	8.33
20	-	-	-	-	-	-

Treasury Department, Division of Research and Statistics.

January 4, 1939.

Yields are shown as nominal rates compounded semiannually.

### INTEREST YIELD ON U.S. SAVINGS BONDS COMPARED WITH THAT ON TREASURY BONDS



January 16, 1940

3:00 p.m.

PRESENT:

Mr. Chen  
Dr. White  
Mr. Cochran

HM,Jr: Well, how's everything?

Mr. Chen: Everything seems moving along. I cannot say either way, it's good or bad. Wood oil coming very rapidly and I think by end of this month we will have about 10,000 tons in New York again.

Tin, we expect first shipment on the end of this month will arrive San Francisco. 500 tons. It is already on board ship. It's on the American boat President Coolidge.

Tungsten, we have 3,000 tons in Haiphong and still negotiating with the French Government to release that and I think French Government will consider favorably if it is shipped to America and England.

HM,Jr: Oh, I see.

Mr. Chen: So possibly half will be shipped to this country. I cannot say officially how much will be made available but urged Dr. Kung the need of this country but I have not heard yet as to the negotiation that is going on. Transportation is a little bit difficult because Indo-China -- French railway has been bombed and there was interruption there but between sections traffic still going on.

HM,Jr: Must be very difficult.

Mr. Chen: They are using carriers to carry it on shoulders to put on another section and the French Governor has had understanding in the China section -- the Chinese Government will put some anti-aircraft guns to stop.....

- 2 -

HM,Jr: Who's going to do that?

Mr. Chen: Chinese Government, and also we have large number of people working on that Rangoon road, traffic just as usual. Of course road bed is rather soft and some sharp angles have to be fixed up, so they are putting lots of men on that. New road, it's not quite ready yet.

I am asking Dr. Buck to make trip to see this road and also make careful study of this tin -- whole business -- and he may be back about end of March and have all these reports ready.

HM,Jr: Good.

Mr. Chen: The funds will be finished by the end of this month so we hope we can do some business together.

HM,Jr: I hope so too. It's very difficult. I have nothing encouraging to report to you, but I have not given up hope.

Mr. Chen: That's fine.

HM,Jr: It's hard work though.

Mr. Chen: Yes. Look upon you to help us, help China in this great cause.

HM,Jr: I am doing all I can but it's not easy.

Mr. Chen: I know. You have been very helpful, especially this critical time and if some arrangement could be made it would mean so much for this cause.

HM,Jr: I know.

Mr. Chen: China has only one person, that's you, to help.

HM,Jr: It has to be done by the President, I am only his servant.

Mr. Chen: Do you think we should call on Jesse Jones?

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HM, Jr: I think I would call on Jesse Jones and if Mr. Pierson is out of the hospital I would call on him. If your Ambassador could take you around to see Mr. Hull I think that would be helpful. I think if he could take you around to see him I think it would be very helpful.

Mr. Chen: Do you think -- I am just asking questions -- do you think it would be easier after Finland credit has been arranged? Do you think China could.....

HM, Jr: I think it would be easier. If Finland gets its credit it will be easier to give it to China.

Mr. Chen: That should be passed quite quickly?

HM, Jr: I just read the ticker that it did not get a very good reception on the Hill -- the President's letter. Didn't get -- at least what the ticker said it didn't get a very good reception.

It's all very difficult. I would see Jesse Jones and Warren Pierson. I think if your Ambassador could see Mr. Hull and keep after him and you keep after me.

Mr. Chen: I don't need to keep after you. I know your whole heart is with this cause and I wish to thank you again for this trouble you have taken and we depend upon you.

oo O oo

January 16, 1940.  
2:55 p.m.

H.M.Jr: Hello.  
Captain  
Collins: Yes, Mr. Secretary.

H.M.Jr: Captain, the President is calling a meeting in his office for tomorrow morning what I call the Collins Board plus Chief of the Aviation, Admiral Towers and myself, see?

C: Yes sir.

H.M.Jr: Hello.

C: Yes sir, I'm listening.

H.M.Jr: To go into this whole thing.

C: Yes sir.

H.M.Jr: And report directly to him. We'll know a little later what time it's going to be.

C: Yes sir. Well that will - that will be my own Procurement Board.

H.M.Jr: What I call the Collins Board.

C: The Admiral and the General.

H.M.Jr: Admiral and the General.

C: Aye aye sir.

H.M.Jr: The head of Army Air Corps.

C: Yes sir.

H.M.Jr: And Admiral Towers.

C: Yes sir.

H.M.Jr: Is he the head of Navy Aviation?

C: Yes sir. He is. Well I'll tell my gang to stand by for a further call.

H.M.Jr: Tomorrow.

C: Aye aye sir.

H.M.Jr: Right.

C: Thank you sir.  
H.M.Jr: By that time you'll know won't you?  
C: I should, yes sir.  
H.M.Jr: Right.  
C: Aye aye sir.  
H.M.Jr: Thank you.  
C: Goodbye.

Federal Bureau of Investigation  
United States Department of Justice  
Washington, D. C.

January 16, 1940

The Honorable  
The Secretary of the Treasury  
Washington, D. C.

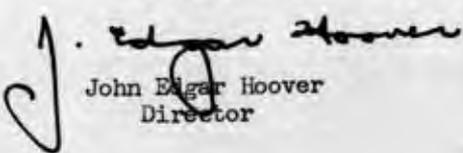
My dear Mr. Secretary:

I am enclosing a copy of a memorandum dated January 13, 1940, supplementing previous information furnished to you concerning the activities of Adam Von Trott zu Solz of Germany, who ostensibly came to the United States to attend a conference of the Institute of Pacific Relations which was held at the Cavalier Hotel, Virginia Beach, Virginia, from November 22, 1939, to December 2, 1939, inclusive, but who is reported to be soliciting the assistance of a number of prominent individuals in the United States in supporting a movement involving the overthrow of the present regime in Germany.

Von Trott departed from San Francisco, California, on the SS President Cleveland on January 12, 1940, apparently for Yokohama, Japan, China, and planned to travel via Trans-Siberia Railway to Moscow and then to Berlin.

The information contained in the attached memorandum will be supplemented in the near future.

Sincerely yours,

  
John Edgar Hoover  
Director

Enclosure

Federal Bureau of Investigation  
United States Department of Justice  
Washington, D. C.

January 16, 1940

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Sincerely yours,

John Edgar Hoover  
Director

Enclosure

67-23-10 NY 100

January 13, 1940

MEMORANDUM

Re: DR. ADAM VON TROTT ZU SOLZ, with aliases:  
ADAM VON TROTT ZU SOLZ, ADAM VON TROFF  
ZU SOLZ, ADAM VON TROTT ZU SOLE

The following information is set forth to supplement the memorandum of December 16, 1939, regarding the activities of Dr. Adam Von Trott zu Solz who arrived in New York City on October 2, 1939, from Europe ostensibly to attend a conference of the Institute of Pacific Relations which was held at the Cavalier Hotel, Virginia Beach, Virginia, between November 22 and December 2, 1939, inclusive, but who is reported in reality to be visiting the United States for the purpose of soliciting the assistance of a few prominent individuals in a plan to overthrow the present regime in Germany.

Since the submission of the previous memorandum further information has been received regarding the identities of Dr. Hans Muhle and Hans-Haseo Von Seebach, also known as Arthur Seebach, who have been in frequent contact with Von Trott since his arrival in the United States and who have apparently collaborated with him on many occasions concerning the part which Von Trott was to play at the conference of the Institute of Pacific Relations and his activities subsequent thereto.

Dr. Hans Muhle departed from Southampton, England, on December 2, 1938, and arrived in New York City on December 9, 1938, aboard the SS Washington. At this time he stated his age was 39 and his occupation was listed as that of a clerk. Dr. Muhle advised the Immigration Authorities that he was born in Hamburg, Germany, and gave as his last residence Berlin and his nearest relative M. Muhle, Gov. Wagner Fru Tal 12, Berlin.

Dr. Hans Muhle was admitted by the Immigration Authorities on Immigration Visa QIV326 issued at Lyon, France, on October 29, 1938. Dr. Muhle advised at the time of his entry that he intended to join a friend, R. Scherer, 19410 Lucerna Drive, Detroit, Michigan, and further indicated that he intended to remain in the United States permanently. It is reported that he was for a time employed by the Bank of Manhattan, New York City, and later became treasurer of the Schering Corporation, Bloomfield, New Jersey. Dr. Muhle is reported to be an expert economist and has a Ph.D. degree.

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It should be noted that the Schering Corporation and the Saraka Company, manufacturers of medicine, are under the same management, Saraka being the name of the leading medicine produced by the Schering Corporation. Stockholders and Directors of the Schering Corporation are reported to be Russian and German Jewish doctors who have fled from Europe. The corporation has an excellent financial rating and capital estimated at \$2,500,000, and is building an additional plant in Union, New Jersey. It is described as being patriotic to American ideals and fair to labor. The concern, however, is believed to have a subsidiary in Germany, although the exact location is unknown. Dr. J. Weltzien, President of the Corporation, is a former German doctor who conducts extensive laboratory experiments at his residence at Short Hills, New Jersey.

Dr. Buhls at the present time is residing at 18 Clarendon Place, Bloomfield, New Jersey, and receives large quantities of mail from Germany.

Hans-Hasso Von Seebach first arrived in the United States on March 26, 1936, at New York City on the SS Conte di Savoia, at which time he was in possession of passport No. 156-1103-34 issued at Berlin, Germany, on February 15, 1934, to expire on February 14, 1939. At the time of his arrival Seebach entered the United States as a nonimmigrant under Section 3 of the Immigration Act of 1934. He apparently was admitted to the United States for a six-month visit, but his time has been extended on several occasions.

From the records of the Immigration Authorities at New York City it appears that Von Seebach for a time resided at Carmel, California, where Julie Braun nee Vogelstein had also resided, their Post Office Box being No. 147A. Von Seebach apparently moved to New York City with Julie Braun in September or October 1939, and occupied a suite at the Crovlen Hotel with her. It appears that Julie Braun is an authoress who is the recipient of the benefits of a trust fund representing securities valued at \$300,000 in 1936. It has been ascertained that Von Seebach is a nephew of Mrs. Braun and according to information furnished the Immigration Authorities, was assisting her in liquidating large interests in Germany.

The records further reflect that Von Seebach had been previously connected with the United Press in Berlin, Germany, and was in the United States to continue scientific research

to which Mrs. Braun was contributing a large part of her fortune. In one affidavit for an extension of the time allowed for his visit to the United States, Von Seebach indicated he was studying American conditions and American journalism with the cooperation of important publishers such as Victor Ridder who is vice president of the Pioneer Press Dispatch Company, and treasurer of the New York Staats Zeitung, and who maintains offices at 22 North William Street, New York City.

In December 1937, Von Seebach left the United States returning in March of 1938 under a temporary visa, leaving for Cuba via Miami in May of 1938. It is believed that he returned to the United States via Miami in 1938, although the exact date has not been established as yet.

On November 1, 1939, Dr. Von Trott held a conversation at the Shoreham Hotel in New York City with an individual believed to have been Hans-Hasso Von Seebach, at which time Von Trott stated that as far as he was concerned the future was clear and mentioned that he had submitted a memorandum which had been acted upon and had received the following comments: 1. the resolutions were too general in nature and did not lend themselves to any specific treatment; 2. the weaknesses of the League of Nations were too general. This undoubtedly had reference to a paper or document which Von Trott was apparently preparing in connection with the conference of the Institute of Pacific Relations which was then to have been held during the latter part of November and the first of December, 1939.

The conversation then turned to individuals of mutual acquaintance. Von Trott stated that Simons, apparently referring to Hans Simons, professor of the New School for Social Research, whose accomplishments were set forth in a memorandum of December 16, 1939, was very lazy and had done nothing on this matter. Von Trott apparently referred to a document which he was preparing in collaboration with others, relative to the remedy for the ills of the present political situation in Europe. Dr. Von Trott then mentioned Muhle, apparently referring to Dr. Hans Muhle mentioned previously in this memorandum, as being a well informed man whom he was willing to defend. He then spoke of the diplomatic qualities of Muhle and stated he was not easily influenced and that in the presence of Americans he would be in a position to "stand by Germany". Von Trott then mentioned that the time was becoming more and more limited and that he was presently working on the Agenda of the Pacific conference and had in mind the presentation of a memorandum.

The individual believed to have been Von Seebach then spoke of someone, name not mentioned, who would be able to go to England to assist them. Von Trott queried whether Muhle should know of this. Von Seebach then spoke of three Americans, Elkins, Lang and Lipson, but referred to Elkins as a beginner. Von Seebach then referred to an incident in which someone had questioned him why Von Trott was invited to the conference, apparently referring to the Institute of Pacific Relations, to which Seebach replied that Von Trott was a young man who had been "incidentally selected" to represent Middle Europe, and that he was not a representative of Hitler, and further commented that Von Trott was worthy of representing the German people themselves. Von Seebach then stated that the unnamed individual replied that it was peculiar the Nazis had not selected their own representative. Von Seebach stated that Dr. Matig (phonetic) would make use of the impression made by Von Trott, and at this point the other individual walked away commenting that he did not care to have anything to do with it.

Dr. Von Trott again referred to Simons who he stated should be told that it was their purpose to create a memorial in writing which was intended to impress American politics and yet be effective in Germany.

Von Trott then mentioned Scheffer, apparently identical with Paul Scheffer, former Editor-in-Chief of the Berlin Tageblatt, who was ousted in 1936 by the German Minister of Propaganda Goebbels because of his liberal and anti-Nazi sympathies, and described him as being well informed but indiscreet. It will be recalled that Von Trott has collaborated with Scheffer on several occasions in the past. The names of Dallas (phonetic), Muhle, Bruening, former Chancellor of Germany and presently professor at Harvard University, and Rieszler, apparently identical with Kurt Rieszler, professor of Philosophy at the New School of Social Research, were mentioned and the necessity of financing Dr. Muhle was commented upon. Dr. Von Trott and Von Seebach then examined some document and made certain revisions. Von Trott then asked Von Seebach's advice as to whether it was advisable to replace Dr. Muhle with a young Socialist from the Institute, stating that Muhle had been involved in matters of this type for years and yet had a very narrow experience. However, Von Seebach was not convinced of this.

Von Seebach replied that Dr. Muhle was too smart and pretended to be without fault, and suggested that Riezier was not as obstinate as Muhle. Von Trott replied that there must be an aggressive administration to successfully dethrone Hitler. Von Seebach then referred to a program outlining objectives and methods of accomplishments. Von Trott responded by stating that every effort should be made to accomplish their aims. Von Trott stated that he would direct a letter to either Bruening or Muhle that evening inquiring as to what form the outline should take, apparently referring to the discussion which was to be proposed at the conference of the Institute of Pacific Relations. Attention is invited to page 12 and subsequent pages of the memorandum of December 16, 1939, quoting correspondence between Dr. Bruening and Von Trott.

On November 1, 1939, Von Trott conversed with Mrs. Elliott Pratt of One East End Avenue, New York City, who has been in frequent contact with him during his sojourn in New York City. Von Trott mentioned the conference of the Institute of Pacific Relations and advised that the Agenda for the conference had been drawn up by the New York Office, Australia, New Zealand, Canada, England and America. He stated that there would be one German, one Japanese and one Italian, and he himself would represent the Far East and General McCoy would represent the United States along with others. Von Trott advised Mrs. Pratt that Russia and Japan would not be represented and he, in all probability, would speak for those countries. He added, however, that outsiders would not be permitted to attend the conference and further that the press would be excluded from the meetings.

On November 2, 1939, Von Trott conversed with Miss Ingrid Warburg, during the course of which he mentioned a visit of Von Seebach. He requested her to instruct Von Seebach that he Von Trott was in danger of his life and that Von Seebach should absolutely refrain from repeating any information which he had secured from Von Trott.

On November 2, 1939, Von Trott also held a conversation with an individual believed to have been Paul Scheffer, during which Von Trott referred to a person by the name of Fuhlner (phonetic) who recently came to the United States from Germany and would be of great assistance. Scheffer stated he would like to talk with him and give him some detailed

instructions, to which Von Trott replied that it could not be done in New York for he was there only for a limited period of time and would have to be contacted in Boston.

Von Trott then referred to an individual named Schnitzman (phonetic) and a discussion followed as to this party's opinion of the present problem. Von Trott stated his interpretation was entirely theoretical, to which Scheffer replied with a remark to the effect that very few people understood Hitler and that the American people, although they read the newspapers, give it very little thought and were unfortunately misinformed. Von Trott stated that the political lines in Europe were limited. Scheffer replied the present situation seemed to be that of reaction against reaction. Von Trott stated he had described the situation to Dr. Bruening and remarked "Can you imagine seeing Bruening sitting with five other Germans and with twelve Americans at a round table without getting into each others hair?"

Scheffer stated he had two theories as to the conclusion of the war; first, that the war would run its course and create an entire new situation. Von Trott demanded an explanation of the term "entire new situation" and whether this really involved the abdication of Hitler, and whether this new situation was possible under Victorian conditions. Scheffer responded that the new situation would only be created by the abdication of Hitler. The second theory pertained to the victory of Germany and Von Trott remarked that if Russia would instill the German efficiency among its ranks, then it would be all powerful, and that if Hitler were set aside and political developments were proper, it would certainly help Germany very much.

Scheffer stated that in Russia there was a permanent state of disorder and referred to it as an "internal mess" and stated that it must be admitted that Russia cannot be depended upon because Russia "yessed" Germany every time, to Germany's detriment. He stated that Russia has maintained Communistic schools for the training of German Communistic Agents, but Von Trott replied that Germans do not work in that manner. Scheffer continued, however, that these Russian Communists are waiting like demons for Germany.

Scheffer then named Buchert (phonetic) and Bela Kun (phonetic) as two outstanding Agents and Revolutionists. Buchert was apparently raised in Heidelberg and has been in Moscow for years, and Scheffer contended that this person led a group of Russians even though the element of Marxism had already taken hold of the working class. Scheffer stated that the German working class was different because of their standard of living which was higher than that of the Russians. He remarked, however, that the Germans are very sensitive as to their standard of living and that Germany was not entirely free of the Russian situation, and that such well informed men as Bruening, were aware of this fact.

A second conversation between Von Trott and Von Seebach occurred on November 2, 1939. On this occasion Von Trott remarked that Bruening's growing indifference was due to the lack of sufficient financial support. Seebach then queried as to whether Von Trott had received a reply from him, to which the answer was a negative one. Seebach then remarked that Bruening was fickle and Von Trott replied that some people had stated Bruening made the most solemn promises and then did nothing further.

Von Seebach asked Von Trott whether Dr. Muhle could be considered as a consultant who could be trusted. Von Trott replied that all questions which would not pertain to the practical angle should be referred to him.

On November 4, 1939, Von Trott conversed with Miss Anne Boardman, at which time she was given a memorandum which he had in his possession to read, and asked her to pass upon the English and punctuation of it. He then remarked that it was necessary to get vision before the people and that it was time to get it across to the Germans or to Hitler and the Army. Miss Boardman commented that she doubted whether it would make any impression upon Hitler and then questioned Von Trott about the revolution to which he replied "listen, Anne, I am putting my life into your hands". Miss Boardman admitted that this was true and then asked whether there was a group at the present time who could take over if the present regime was upset. Von Trott replied that some of those who "do exist could be unified". Miss Boardman then apparently dictated corrections for the memorandum as follows:

"If on the other hand the German masses groping for some venerable alternative from Hitler, are met with continuing vagueness from the Western powers, their desperate hopes are bound to turn eastward once more and inevitably pressed in the direction of the East."

On November 10, 1939, Von Trott held another conference with Paul Scheffer. He stated that the National Geographic group would be very desirable if proper diplomatic relations could be maintained and expressed his indignation over the fact that Stimson, during the last few days, had referred to Von Trott as a Nazi. Considerable discussion followed as to whether he had said this for the purpose of protecting Von Trott or for the purpose of maligning him. Scheffer then referred to the development of agricultural groups in Germany and how they had been carried over into Czechoslovakia prior to its annexation by Germany. Scheffer then asked whether Von Trott had heard anything of importance from Washington. Von Trott responded that he had heard that Mr. Roosevelt had had a conference, stating that he would not like to see the United States enter the war and spoke also regarding the lifting of the Embargo and the extension of the United States' jurisdiction on the high seas. Von Trott replied that there was a growing tendency for peace in England. Scheffer referred to a meeting of the National Socialist faction and Von Trott queried as to whether there were any people there who knew who was behind it all. Scheffer stated there was one Oppen (phonetic) and many others but that it could not be definitely determined.

Scheffer then referred to the organization of the National Democratic Party in Germany. Von Trott replied that the great problem confronting them was the establishing of a connecting link between the military officials and the nobility on the one side, and the working class and the agrarians on the other side. A cultural problem was also involved. Hess was referred to as being in error in contending that England would not be of any aid.

During this discussion Von Trott received a long distance call from Mr. Stone, Vice President of the Foreign Policies Association, New York City and Haruger of the Washington, D. C. office, who advised he had furnished a copy of Von Trott's document to Mrs. Welles and Mr. Messersmith, both Assistant Secretaries of the State Department at Washington, D. C. Stone commented on the fact that Mr. Welles apparently was acquainted with Von Trott's presence in the United States which appeared to be suspicious to both Von Trott and Mr. Stone.

On November 13, 1939, while in conversation with Von Seebach, Von Trott handed Von Seebach a piece of correspondence for his consideration. Seebach then referred to a second letter which Von Trott had received from Caspari and stated that it was regrettable that Caspari could not be in New York. Seebach commented to the effect that the self-administrative groups promulgated by Caspari were a good idea but impracticable, and then remarked that Caspari's uncle was an intimate friend of Valera (phonetic). Caspari is apparently identical with Fritz Caspari who arrived in New York City from abroad with Von Trott on October 2, 1939, and who is presently teaching at Scripps College, Claremont, California.

On November 15, 1939, in a conversation with Von Seebach, Von Trott referred to Dr. Bruening as being an individual who could not be depended upon and described Schaffer as a hard worker who means well and is not susceptible to praise, and an individual with a good reputation among important people. Von Trott referred to General McCoy as one of those who was an expert but who viewed the plan (apparently Von Trott's plan) with apprehension.

Von Trott mentioned that Dr. Bruening was not in favor of a complete revision of power in Germany and was greatly in fear of the constitutional forum. He stated that Bruening was very much of a Catholic and that when one speaks to him one thinks he is speaking to his father, and that all of the memoranda coming from him have been of immeasurable value.

Von Trott went on to state that the English sentiment as expressed by Winston Churchill, was that they should fight until death, and that Hamilton Fish Armstrong expressed the same view. Von Trott referred to Armstrong as being weak and very temperamental, but unselfish. He stated that they must collect information regarding the German problem and that McCoy and DeVilla (phonetic) had helped in this regard. Von Trott stated that the Americans were selfish and considered that the Germans were a group of "deadheads". Von Trott advised, however, that the pride of the German people was at stake. Von Trott stated that new groups have arisen in Germany which possess agrarian support and that it was incumbent upon them to show that the war has placed Germany in a very precarious position which is recognized in foreign countries, and which is a matter that must be faced by those acquainted with the problems. He stated that the German people should be shown that the present system hindered the individual's development.

He explained that the European War had favored Germany thus far and expressed his belief that if the war had not broken out, another Washington Conference would have taken place. Von Trost stated that at the present time Germany and Japan are close together and that Japan and Russia now regard themselves as fighting together against a world menace and capitalism. The war has put Japan in a powerful position and the friendship of Japan must be retained. Von Trost stated that the results of the last war were first, the isolation of Germany; second, Russian support and the final amalgamation with Russia. He stated that Germany must become Socialist and that personal rights must be restored.

The following is a translation of a document written in German which was inadvertently misplaced by Von Trost:

#### "A German Question

The principle of every truly European solution is the problem of creating an order whereby the German power is established and at the same time provide for the security of the other people in Europe.

The German system does not permit the actual accomplishment of this objective within the European boundaries.

The thought and purpose of the new order is directed toward a limiting of the powers of Germany. Her deserved position of great power is only to become manifest with reference to its relation to Asia, Africa, and America, so far and only so far as peace negotiations are concerned.

Instead of erecting an Anglo-Saxon peace plan every-thing depends upon the contemplated political status of the great powers at the institution of the negotiations as based upon the historical conditions which would be favorable for its accomplishment.

Should one relegate Germany to the 'deserved place' rather than to the 'right place' then one brings up the question of guilt and one risks the European peace by branding it at its inception as being Anglo-Saxon in character and not to be observed by Germany. Then again a lack of confidence would arise.

" Then the problem is to grant such powers to Germany which would be approved of by the other European powers. Germany's role as a peaceful nation and a factor in the defense of security in Central Europe will be negative and denied because it does not have the position or the background for envisioning the will and power for activity beyond the boundaries of Europe.

The peace negotiations must, therefore, be divided into two related topics.

#### I The new order of Europe

1. General discussion of the question concerning minorities under the fundamental supposition of bringing about a solution through territorial, economic, and national laws one must definitely depart from the national socialistic watch word of that state and the nation must be one unit. The continuation of these factors is only passable by means of a compromise, as long as it proves convincing and illustrates the value of a state-nation combination. Special emphasis must be placed in East Europe upon the problem of establishing plausible examples.

On the German side of the question of the minorities has undergone two phases since the war.

a. The forceful separation of German people by the Versailles Treaty. This phase may be viewed in every respect as having been exploded.

b. The forceful re-establishment of all notable German minorities in Germany and the simultaneous oppression of foreign racial groups.

The second phase does not only concern the political, but on the side of Germany it also means a spiritual triumph if England and France in a Union with Germany create a new order in East Europe so that East Europe will not again be the theater of controversy in Eastern and Middle European rivalry. A result of the latest development of the National Socialistic efforts to solve the problems of the minorities (the resettlement of the Balkans, the citizens of the section of Sieben, and the South Tyrolians) may be attributed to the German and European results of such politics as:

" a. The formalistic and forceful political solution of the minority problem destroys the national basis for the community of political fate of the East European people. In an unnatural and in an artificial manner the people are separated from each other and become estranged without having overcome the geographical political problem.

b. Germany especially exchanges for the cultural and political objectives of its cultural and political minorities in East Europe, a large state in which these special characteristics of the German people are absorbed.

I Special Comment.

a. The Polish Question.

Poland can only be satisfied by permitting it to have an outlet to the seas. The corridor is unbearable for Germany. In the same manner a cessation of East Russia to become a part of Poland and the simultaneous resettlement of the Germans with West Prussia would be unbearable for Germany. A middle course must be discovered which would retain for the Germans the cultural element of the province and at the same time give Poland supreme command of the interior.

Solution: Establishment of a Polish, Lithuanian, Prussian Federation occupying the present territory of Lithuania, East Prussia and the preponderantly Polish sections occupied by Russia and Germany which at one time were a part of the Republic of Poland. Under the Federation Poland would have to assume a more compact form than that assumed by the three Donan countries and the suggested form for the Balkan states. As to currency and cultural matters Lithuania and East Prussia would be autonomous with Poland having supreme control of military, police, national defense, foreign matters and jurisdiction in matters pertaining to the higher courts. The character of the Federation manifests itself in the representation of Lithuania and East Prussia in the Federal Legislature and in the Superior Court. The President will be elected by the citizens of the three countries and shall be known as the Polish State President. As to the question of Polish police administration in East Prussia the solving

\*of the German-Polish controversy will have a tendency to rectify the German thoughts along this line. This is only passable if the pacifying of Europe goes hand in hand with the establishment of Germany as a world power. Russia will probably not relinquish control of Estonia and Latvia nor of the occupied Polish sectors.

Conclusion: The Polish-Lithuanian-Prussian Federation guarantees to Poland all of the superior regions within the boundaries of the European Federation; to the Germans and Lithuanians cultural autonomy and representation in the central legislature and executive branches.

b. The Czechoslovakian Question.

From an economic standpoint it is very questionable whether the mountainous lands near Bohemia should remain a part of Germany. In the solution of these European problems within the boundaries of Europe account must be given to the strategic psychological developments. The last suggestion which was submitted at Munich which was based upon an example worked out by Switzerland, could be utilized as a regulatory device for the control of Czechoslovakian and German matters.

c. The Danian Federation Question.

The creation of a federation of Czechoslovakia, Slovakia, Hungary, and Austria appears from the standpoint of the balance of European powers as well as from the sovereignty and liberty of the four peoples as well as from the Germanic cultural characteristics certain. The question however arises whether the severance of East Prussia (with a retention of West Prussia) Sudetenland and Austria (both provinces having been secured through the tolerance of England and France) could possibly be borne by Germany. Should this objection prove to be unsurmountable, then the following may come to pass.

a. The voluntary annexation of Czechoslovakia to the Polish Federation. A revision of the already altered form of Government may be of Polish interest because of the greater strength of this type of government.

b. The voluntary annexation of Czechoslovakia to Germany under a guarantee of complete autonomy with the exception of military control, customs, and foreign matters. In the event of a Federation with Germany by Czechoslovakia and Hungary, then their votes, if Slovakia does not federate with Hungary and the other Balkan states, in combination with Austria and Bavaria, could be of great influence.

c. The question as to the European Federal constitution.

The division of Europe into powerful national and federated units brings with it the danger of enemy bloc formation. This tendency can be controlled by interweaving the new political order with the raw products of the working class element through.

a. Organizing of the European Agrarians (Production and consumption).

b. Restricting the European munitions manufacturers in a narrow sense, in conjunction with the European military constitution.

c. Organizing and developing of public utilities in so far as they are of international significance. For instance, the production of electricity from water power.

II The Assurances of further world wide development of Germany.

#### A. Africa.

With the exception of the territory near the coast and the South African Union, Africa will be for all European nations an open field for business development, considering the following points.

a. The political status of the world powers. (The fundamentals of the English and French colonial possessions incorporates political control and to an extent business privileges as to present ownership).

" b. The noticeable German demand for exploitation of raw materials, business privileges, and settlement within limited boundaries (Establishment of commercial colonies and farms).

B. Asia

In Asia, England and France are collaborating in making out a minimum English and French export market.

c. America

Inasmuch as Africa must be considered in conjunction with the new order of Europe, negotiations must be engaged in for the creation of an export market in Asia and America together with a loan to Germany for the purpose of moving the German instruments of production and to mobilise it in accordance with the new European order.

At the conclusion one must determine of what England's mediatory power exists and what culmination it will have as capital of the Empire. Only by definitely considering this position is England's prior existing interest in the European balancing of power to be paralyzed. This must come to pass in order that every general European solution stand in opposition to this traditional English policy.

The Russian question is only to be answered as a result of inferences drawn from conditions existing at the time of the institution of negotiations. The absorption of Estonia, Latvia, Bessarabia (a part of Mongolia) may definitely establish the consent of Russia to a European Union."

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"The Question of the National State

The national state has that historical form which it acquired through the striving, during the 19th century, of the large European nations for independence. During the time that England and France through the national monarchy triumphed

"over the concentrated forces of the feudal lords and accomplished unity, Italy and Germany waited until the present century to launch a battle whereby freedom is to be gained by disposing of foreign control and by declaring war against those who cause internal turmoil. To Eastern Europe the progress toward the materialization of the efforts put forth to accomplish unity and freedom was thwarted through (1) the misfortune of the division of Poland (2) and the failure of the dual monarchy in its historical purpose with reference to the subjects to which it was obligated who were abiding by a platform of freedom and justice as to state matters.

The Versailles Treaty, in spirit, attempted a reaction and to accomplish neglected matters at a time when it was also attempting a solution of problems arising due to changed spiritual and material conditions.

Principles pertaining to the National Small Independent State.

1. Foreign politics.

The downfall of Germany in 1918 created in the East a possibility for the exercising of political powers which actually do not exist, by the small nations. The historical power of a national state consists of 1. A cultural and political objective; 2. The expression of the political power in the sovereign form. The latter is not possible in the small nation. If they have obtained their freedom then their political objective is to maintain and strengthen it (usually at the sacrifice of all friendly nations).

a. By seeking the aid of a large power for protection against another nation, (This is a very prolific source for lack of confidence and animosity to arise between the large powers).

b. By creating and furthering international confidence and thus hindering the balancing of power of the opportunist method.

\*2. Internal politics.

This condition of lasting peril and insecurity with reference to foreign matters requires the exercise of a strong hand internally. At all times the total power of the state must stand in a condition of readiness in order to protect that principle which at that instant is most vulnerable. Already in this regard the democratic powers find themselves at a disadvantage in comparison with those which are totally organized even though its composition is conducive to liberty and guarantees, a well regulated present and future. On the contrary, the smaller nations of the East do not rest upon the second basis of hundreds of years of tradition whose powers alone withstood the catastrophe of 1918. The liberty of their citizens requires certain national independence. The continued peril and inadequacy of self possessed powers for the establishment of autonomy requires internal suppression.

In a combination the small nations of the East are naturally an element of permanent peril and likewise a reaction for European civilization. The 'Balkanizing' of the entire Eastern Europe by the Versailles Treaty caused a permanent suppression of an essential portion of the people of Europe. If the objective is to unite all Europeans with a state assuring security and liberty for its citizens, then there must, as far as East Europe is concerned, be an elimination of the chief weakness, the small lifeless state; with this there must also be the elimination of the ideal of the sovereign national state in cases where it is not justified.

The realm of the real political possibility of the national state.--

England, France, Spain and Italy developed a national state simultaneously within their national boundaries. The Scandinavian countries have been reluctant but they have discussed the question among themselves in a feasible manner. Holland and Belgium now find themselves in a middle position in relation to the three great powers. In the mountainous country of Switzerland, heterogeneous people, both geographically and politically, constitute a state. Germany has passed through a changing history ranging from the dissolution of small political subdivisions with subsequent regret to the combination of all

"Germans into one regime. It appears that the ideal of the national state has also been attained by the Germans. The results of having reached this objective are: There has been a going beyond of the possible real political boundaries of the national state in order that the common interest of the people of Western Europe could be sustained. Europe threatened to be blown asunder from the center. The Eastern boundary has been proved to have been drawn from an ethnographic standpoint which cannot be maintained strategically and which is economically unsound. Slavic people are incorporated into the German Empire by the millions. Russia is going beyond the boundaries of Europe. England and France declare the war.

The small eastern states were made legitimate through the treaty of Versailles, adopted territorial boundaries and minimum state powers which were supposed to substitute for the powers possessed by the surrounding territories. Germany has gone beyond the principle of the national state.

The point of differentiation between the expansion of the ideal of the national state and an impatient substitute lies in the willingness of the European peoples to work together for Germany that meant a sacrifice of 20% of its citizens and at the same time assured a German-European possibility to accommodate these within the boundary of the East European Federation.

For the people of Eastern Europe it meant a sacrifice of the imaginary absolute national state and a decision to ally themselves with the small neighboring states into a federation based upon freedom and justice. Germany will be assured its position among the world powers through conditions existing outside of Europe.

Of specific interest for Europe would be the annexation of East Prussia and Austria to become a part of the proposed Eastern European Federation and that both provinces would become examples of the new state order and that due to their internal structure would be in a better position to establish a WALL against the Pan-Slavism, in a much better manner than greater Germany ever could. The oppressed or the threatened Slavs through the preponderant majority of Germans will seek their salvation in Russia.

" The failure of the Danubian Monarchy in accomplishing its objective of combining the South and West European Slavs in order to prevent the enemy country Russia from encroaching could be taken up by the German element in the Polish-Lithuanian-Prussian and in the Czechoslovakia-Austrian-Hungarian federations."

While attending the conference of the Institute of Pacific Relations at Virginia Beach, Virginia, a conversation took place between Von Trott, John W. Wheeler-Bennett, whose accomplishments were set forth on page 35 of the memorandum of December 16, 1939, J. F. Parkinson, Professor, University of Toronto, and a Mr. Dunton, whose identity is unknown.

Von Trott asked one of the visitors whether he was of the opinion that England could assist his country in executing a plan bringing about equal trade rights, and to this there was a reply that all countries would have to cooperate.

The conversation then turned to the publicity formula for this cooperation and it was agreed that the formula was one word - "Cooperation" - to give and to take. Von Trott stated that Germany could not expect an agreement with Britain unless England was willing to give. Wheeler-Bennett then responded "That is what we have been trying to do".

There was then a discussion of colonies and it was suggested that there could probably be worked out an agreement based upon the idea of an International Charter Company somewhat akin to the old East India Company. One of the visitors suggested that such an idea would be conducive to freedom of exchange.

Von Trott was asked by one of the visitors if Germany would be agreeable to the International Charter Company. Von Trott stated that his country would have a capital range of from three to four billion dollars and that Germany would be required to have at least three-fourths of a billion investment in such a company if it were to be accorded the advantages offered by such a company. Von Trott stated that such a company could best be operated under a confederation of European states. One of the visitors stated that the chief advantage of such a confederation would be to bring about concerted action with reference to foreign matters. Von Trott agreed in part but stated that the combination of European states would serve to establish security of their citizens and property and that only those states which would conform to the constitutional principles set forth by the confederation could become members thereof.

Mr. Wheeler-Bennett stated that if Germany reestablished the Reichstag then England would guarantee a freedom of trade. Von Trott queried "And the present blockade?" There was no response.

The conversation then switched to a discussion of the reestablishment of the Reichstag and Von Trott stated that Germany would insist upon freedom - that she did not want any one or several foreign powers to hold a whip over her. Von Trott was of the belief that under this arrangement a substantial number of Jewish refugees would be able to return to Germany. He stated that Goebbels had at one time expressed this opinion. One of the visitors then stated that the whole point was to make realistic that which heretofore had been idealistic. It was stated that there must be a realistic peace because at the close of the last war there was an idealistic one.

One of the visitors then reminded Von Trott that there would not be another Munich agreement.

A discussion of a possible confederation of European states followed and it was suggested that the proper way to determine this would be by a plebiscite. One of the visitors stated that by this method Czechoslovakia and Latvia would become acting members of the federation. It was then stated that Austria was one hundred per cent German and that the Sudetenland was eighty-nine per cent German. Von Trott remarked that what Germany wanted was a strategic point in the land of the hills (Czechoslovakia) in order that hostile armies may not exist so near to Germany and endanger its industrial area. He suggested, however, that a plebiscite would be much preferred in Austria.

The discussion then reverted to Russia's recent aggression. Von Trott was questioned as to what Russia could gain by taking Norway (possibly has reference to Finland). One of the visitors suggested that such action would prevent Germany from becoming the dominating power in that section of Europe. Von Trott replied that such action on the part of Russia was strictly in accordance with the German-Russian Agreement inasmuch as the latter was merely a trade agreement and not military in nature. He further brought out that it was not the desire of Russia to participate in Germany's war and added that Germany has had a tremendous accumulation of armaments and can well stand on its own feet. His conclusion of the discussion was that the British naval losses were greater for a given period of time during the present conflict than during the last war.

Von Trott stated that just as soon as Russia came through to Denmark everything would be quiet on the western front until spring when "Hell would break loose on the part of Germany". Mr. Wheeler-Bennett questioned Von Trott as to what he meant by this and Von Trott explained by stating that it would consist of a series of well manned attacks upon numerous vulnerable French points. Von Trott elaborated further by stating that it was the general opinion in Berlin that Hitler's efficacy would become nil after these concentrated attacks.

Mr. Wheeler-Bennett then mentioned Hitler's *Main Kampf* to which Von Trott merely laughed and failed to give a reply, but stated Germany must be given a chance.

One of the visitors then brought out the fact there might be a "naughty boy" who might be called upon to show his hand. Von Trott replied that Germany would continue to act as a "naughty boy" because it did not believe that England was meant to be its administrator by divine guidance.

One of the visitors asked what would be the outcome if Germany was successful and after a moment of silence Wheeler-Bennett stated that under these conditions there would be the establishment of National Bolshevism in Europe. Von Trott in his denial of this stated that "We must unite for a European cause" and that the reasons why Germany could not reach an agreement with England were: (1) England does not desire to give up any of its rights for the benefit of Germany; (2) The vast majority of the German citizens realize that they are socialistic, while England on the other hand is a capitalistic order. Von Trott stated that the great trouble was that the German people were of the opinion that it was the purpose of England not only to perish the German nation but also its people.

During the course of the ensuing conversation, Wheeler-Bennett remarked that England would like to see Germany under a reorganized form of government. Von Trott responded that such a reorganization should be based upon a strongly supported public opinion to which the visitors agreed. Von Trott further remarked that public opinion could only be created over a period of years.

In the discussion which followed the matter of selecting a military representative of the confederation while it was in a formative state was discussed. One of the visitors named a Japanese, General Waihita (phonetic) and another suggested a military official by the name of General Frans, last name not discernible. One of the visitors then stated that before such a selection took place it should be determined what Russia's next move would be. He further stated that it might be time for a Russian Putsch. Von Trott did not agree to this, however, but stated that no doubt Russia would hold a salient position.

The discussion then reverted to the selection of a capable statesman to represent the confederation. One of the visitors suggested a representative from Canada, though no specific party was named. However, it was suggested that this individual should represent not only Canada but Australia and New Zealand as well. A discussion of the mandate system followed and in this connection the name of Anthony Eden of England was mentioned, but a problem arose as to how he could be contacted by them in an effective manner. Von Trott stated he had heard that Rufus M. Jones was very close to Eden and that possible contact could be made through him.

Wheeler-Bennett stated that the initiative seemed to lie with England and that if they were to get the "band wagon" started, the King could then get on, thus bringing the weight of the entire British people behind the plan.

Von Trott seemed of the opinion that it was up to the younger generation to get the plan started and to see that it was carried through.

The following is quoted from a letter dated November 30, 1939, addressed to Von Trott at the Cavalier Hotel, Virginia Beach, Virginia, by Margita Mahle, wife of Dr. Hans Mahle of Bloomfield, New Jersey:

" Dear V. T.

May I introduce a few words in the exchange of letters you are carrying on with Hans. I have both letters before me which have been answered and it does not make any difference how carefully I read these — I am not able to determine any essential political differences in the essential political

"conditions set forth. A moment of thought will disclose to you what the first steps were which guided you along this course. The unanticipated plays a great role in politics and no definite rules can be set down. Hans seems slightly inflexible in this regard, while you probably have the feeling at this pressing moment that the details concerning the confederation are not definitely guaranteed. The aid of the military and the conservative circles may bring out the new points and the conservative socialistic element must be incorporated. While the Marxistic groups are merely considering it as a remote possibility, our daily experiences prove that this is our purpose and I cannot see why we cannot be very much enthusiastic about it. -----"

With hearty greetings,

Yours,

Margita Muhle"

At the conclusion of the conference of the Institute of Pacific Relations at Virginia Beach, Virginia, Dr. Von Trott drove by automobile to Washington, D. C., where he registered at the Mayflower Hotel on December 4, 1939, checking out on December 6, 1939, after which he stayed at the residence of Herbert Von Stempel, First Secretary of the German Embassy, Bethesda, Maryland. Von Trott departed from Washington for New York City on December 8, 1939, via automobile.

During his stay in Washington, D. C., however, Dr. Von Trott contacted Mr. Hans Thomsen, Acting German Ambassador, Constantine Oumansky, Russian Ambassador, Frank K. Officer, Australian Counselor, British Embassy, George S. Messersmith, Assistant Secretary of State, Edward C. Carter, Permanent Secretary of the Institute of Pacific Relations, Felix Morley, Editor of the Washington Post, and Walter Lipman, columnist.

Upon returning to New York City, Von Trott again registered at the Shoreham Hotel on December 8, 1939. Since his return he has again been in contact with Dr. Hans Muhle, Paul Scheffer, Hans-Hasso Von Seebach, Ingrid Warburg and Mrs. Elliott Pratt.

On the night of December 15, 1939, Von Trott traveled by train to Boston, Massachusetts, returning to New York City on the evening of December 17, 1939. On December 18, 1939, an effort was made on the part of an individual who identified himself as Baron Von Gienanth of the German Embassy who was temporarily stopping at the Gladstone Hotel in New York City to contact Von Trott without success. However, on the evenings of December 18, 19 and 20, 1939, Von Trott spent several hours at the Gladstone Hotel apparently in conference with Baron Von Gienanth.

On December 23, 1939, Von Trott traveled by train to Oakland, New Jersey, where he was met at the station and proceeded to the residence of Evelyn Preston who resides on a country estate called Dell Brook Farm, and is considered quite wealthy. Mrs. Preston is reported to have associated with Anna Kauffman who resides in a small house about a half mile from Dell Brook Farm. Anna Kauffman, according to information received, is reported to be an organizer for the Garment Workers Union in New York City and is about twenty-six years of age. Information has further been received that Mrs. Evelyn Preston of Oakland, New Jersey, was arrested while picketing the May Department Store in New York City in November, 1935, and is believed to be a member of the League of Women Shoppers. Von Trott returned to New York City on the evening of December 25, 1939.

On December 30, 1939, Von Trott visited the Immaculate Conception Seminary, West Neck Road, Lloyds Harbor, Long Island, New York, where it was learned from Monsignor Barry that Von Trott had visited him to see Dr. Heinrich Bruening. Monsignor Barry stated that both Heinrich Bruening and Von Trott were not in sympathy with the present German regime.

It has been ascertained that Von Trott departed from New York City on the late afternoon of January 5, 1940, proceeding to Los Angeles, California, and then to San Francisco, from where he departed for Japan on January 12, 1940 aboard the SS President Cleveland.

While in California, it has been reported that Von Trott expects to visit Frits Caspari as evidenced by the following quoted letter dated November 27, 1939, on the stationery of the Scripps College, Claremont, California, which was received by Von Trott at Virginia Beach, Virginia:

Dear Trott:

I thank you very much for your pleasant letter, which was especially pleasant inasmuch as it indicated your whereabouts in this country. I would like to know when you could be expected here in order that I may prepare myself accordingly. Should you arrive here before the fifteenth, that is, around the tenth, you could see Brandt as well as Bergstraesser here in the Southern part since the first person will attend a world political conference (pretty much humbug) in this vicinity. Should you arrange after the fifteenth to arrive, I shall be on my vacation and I shall be at your disposal (with an automobile) to a greater extent than heretofore. If your time permits it, we could spend a few days in the mountains or on the beach and if Seebach is here, we could also call on him. Even though we may not be able to do all of this, I am still looking forward to your coming with pleasure. You are now at your conference in Virginia Beach and maybe one of them will extend my greetings to you; I mean one or the other of your people of your office in San Francisco. Let me hear from you soon what your plans are and whether I can still do something for you in this country.

Ever yours, F. C. "

Recent information has been obtained to the effect that Von Trott will proceed to Yokohama, Japan, then to China, and via Trans-Siberian Railway to Moscow, Russia, from which point he will proceed to Berlin.

## TREASURY DEPARTMENT

## INTER OFFICE COMMUNICATION

DATE January 16, 1940

TO Mr. White  
 FROM Mr. Schmidt

House

Subject: Points of interest concerning Brazilian debt negotiations contained in State Department reports.

## Attitude of Brazilian Governmental Officials:

1. Position taken by Aranha:

a. that payments on the foreign debt should be resumed in the near future; (he has told American diplomatic representatives that he would resign from his post as Minister of Foreign Affairs if debt service is not resumed very soon);

b. that preferential treatment should be accorded to holders of dollar bonds; in this regard, he has even stated that he would ask the Brazilian state and municipal governments to service only their dollar debts;

c. that the Brazilian Government should reach a settlement with holders of sterling and franc bonds first, and then negotiate a more favorable settlement with holders of dollar bonds.

Aranha has contended that he is the only one in the Brazilian Government who favors resumption of payments on the foreign debt but he believes that he is succeeding in bringing the President, the Minister of Finance, and the Chief of Staff of the Army to his point of view. He showed the American Ambassador the cables, which he received when he was in the United States last spring, indicating the Brazilian Government's opposition to the statements which he then made committing Brazil to resume payments on the debt July 1, 1939.

2. President Vargas sees little reason for resuming payments on the foreign debt but "would like to do something for the Americans and the Portuguese".

3. The Minister of Finance, who apparently has handled the recent negotiations, has taken the following positions:

- 2 -

- a. that he desires to reach a settlement soon;
- b. that it should be permanent (although it is reported that he once expressed the thought that it might be best to make a temporary settlement extending over two years);
- c. that dollar bonds should not be given preferential treatment;
- d. that any settlement reached should cover bonds of all governmental entities (i.e., National, State, and Municipal). However, under pressure of the British and French bondholder's representatives he has apparently been willing to agree to apply any payments made to the bonds of the Federal Government alone; under pressure from the Americans he has been willing to return to his original position.
- e. that Brazil can only pay about £3 million but that if conditions improve sufficiently it might go as high as £5 million. Apparently this figure has been mentioned in discussions at which only the representatives of the European bondholders were present so there may be some grounds for believing that when speaking of this figure, he is not including the dollar bonds, although he seems to be referring to the debt as a whole. He has also suggested that the bonds might be converted to milreis obligations, but the bondholders representatives have been unwilling to accept such a proposal.

Positions taken by Bondholder's representatives:

In August, 1939, at the invitation of the Brazilian Government, representatives of the United States, British, and French bondholders went to Rio de Janeiro to negotiate a debt settlement. When the war broke out, the American representative returned home. However, the French and British representatives — both of whom live in Buenos Aires — remained in Brazil (except for brief jaunts to Buenos Aires) where they were subsequently joined by a representative of the Portuguese bondholders <sup>1/</sup> and a second French representative who represented a different group of bondholders than did the first. The positions taken by these representatives of the various bondholders during the course of the discussions in Brazil, have been the following:

1. American:

Mr. Dana Monro, who represented the American bondholders, took the position that he was in Brazil to discuss the treatment to be

<sup>1/</sup> Portuguese bondholders have formally declared holdings of £13 million in Brazilian bonds, but it is estimated that they hold between £20 million and £30 million, primarily in sterling issues.

- 3 -

accorded to dollar bonds alone and that he was not concerned with the treatment of bonds issued in other currencies.

## 2. British:

The representative of the British bondholders, Mr. John Phillimore, has worked for:

- a. a temporary rather than a permanent settlement;
- b. application of any payments to the federal bonds alone;
- c. application of the major portion of any payments to interest rather than to amortization.

While the bondholder's representative in Brazil has contended that any payments made should be applied to the federal bonds alone (which favors the British and the French as against the Americans since federal bonds make up two-thirds of the sterling and franc issues and less than one-half of the dollar issues), the British Government -- in an Aide Memoire sent to the State Department on November 30, 1939 -- implied that the British bondholder's council was working to preserve the general principle of the Aranha Plan 1/ under which the payments made were applied to bonds issued by state and municipal governments as well as those of the federal government.

## 3. French:

As has already been indicated, two French representatives made their appearance in Rio, each representing different groups of bondholders. Mr. Rene Berger was presented in Brazil by the French Ambassador and apparently represents the French association which is the equivalent of the American Foreign Bondholders Protective Council. Mr. Richard Berger, who represents a different bondholders association, has not received the backing of the French Ambassador and is not recognized by Mr. Rene Berger as a legitimate representative of the French bondholder's interests.

1/ To quote from the Aide Memoire: "The (British) Council understand that the American bondholders Protective Council ... share their view that the general principle of this scheme should be preserved in any settlement."

Mr. Rene Berger has generally taken the same position as the representative of the British bondholders although he has at times remarked that the Aranha classification should be retained and payments be made on bonds situated in all classes.

4. Portuguese:

The representative of the Portuguese bondholders is inclined to believe that it may be possible to obtain preferential treatment for the American and Portuguese bondholders. He is opposed to any system of payment depending upon trade balances as Brazil has a passive balance in its trade with Portugal. He prefers that any payments made be applied to state and municipal obligations as well as those of the federal government.

5. On the whole, representatives of the European bondholders are especially anxious to arrange a settlement under which payments would start immediately and they would go a long way toward sacrificing their other objectives (and would even agree to a permanent settlement) in order to obtain immediate resumption of payments.

Action Taken by the State Department:

Since Mr. Munro returned to the United States shortly after the outbreak of the war, the American bondholders had no representative in Brazil during October, November, and December when debt discussions were taking place. Throughout this time, however, the Brazilian Minister of Finance and the representatives of the European bondholders have apparently kept American diplomatic representatives in Rio de Janeiro informed of any developments. The Department of State has in turn instructed the American Ambassador in Brazil to inform the Brazilian Government that it was our firmly held view:

1. that it would be very helpful if a settlement could be reached on Brazil's external indebtedness;
2. that it is essential that no settlement be reached with the other external creditors before agreement is reached with the dollar bondholders;
3. that any settlement to be satisfactory must include the dollar bondholders of State and municipal bonds or leave a sense of great injustice in the United States (which seems to indicate a desire on the part of our Government for a general comprehensive plan such as the Aranha Plan);

- 5 -

4. that if the sums offered were to be relatively small, it may be easier to negotiate a temporary rather than a permanent settlement.

On January 2, 1940 Mr. Feis discussed developments with Mr. Francis White, President of the Foreign Bondholders Protective Council, and informed him of the action taken by the State Department. In the course of this discussion, Mr. White told Mr. Feis that the Council would never take a position in opposition to this Government, that if the Government wished in any of these particular situations to handle a negotiation directly, the Council would simply step aside; it would not ever oppose or criticize such a settlement but would merely pass it on to the bondholders as one negotiated by this Government.

In response to representations made by the American Ambassador to Brazil, the Brazilian Government has informed the State Department that it will not work out an agreement with its other creditors until an agreement for the resumption of dollar payments has been reached with American bondholders.

January 16, 1940

To: The Secretary

From: Mr. Young

Having recieved additional copies of the memorandum to the President prepared by the Treasury Department concerning the income certificate plan for agriculture, I have transmitted a copy of this Treasury memorandum to Mr. Eccles and copies of both the Treasury memorandum and the Federal Reserve memorandum on the same subject to Mr. Harold Smith and Mr. Frederic Delano.

As you are aware, the originals of these memoranda were transmitted to Dr. Currie on January 13th.

*Ry.*

Assistant Secretary Gaston

JAN 3 0 1940

E. H. Foley, Jr.

Re: Definition of "Resident" in New York Tax Law and Applicable Rates.

In the personal income tax law of New York the word "resident" applies only to natural persons and includes any person domiciled in the state, except a person who, though domiciled in the state, maintains no permanent place of abode within the state but does maintain a permanent place of abode without the state and who spends in the aggregate not to exceed 30 days of the taxable year within the state.

In addition, the word "resident" includes any person who maintains a permanent place of abode within the state and spends in the aggregate more than 7 months of the taxable year within the state, whether or not domiciled within the state during any portion of that period.

It follows that (a) if you do not maintain a permanent place of abode in New York but do maintain a permanent place of abode in the District of Columbia, and (b) if you spend less than 30 days of the calendar in New York, you are not a resident upon whom the state income tax is imposed. [L. 1935, c. 286, §1 (Tax Law, §350, subd. 7)]

The rates of the state income tax are 2 per cent of net income up to \$1,000, 3 per cent of net income from \$1,000 up to \$3,000, 4 per cent of net income from \$3,000 up to \$5,000, 5 per cent of net income from \$5,000 up to \$7,000, 6 per cent of net income from \$7,000 up to \$9,000, and 7 per cent of net income in excess of \$9,000. [L. 1938, c. 511 (Tax Law §351)]

In addition to this personal income tax on the net income of residents and on the net income of non-residents derived in the state, there is an emergency tax of 1 per cent on net incomes for 1939. [L. 1939, c. 935 (Tax Law, §351-f)]

Capital gains and losses are separately computed under the New York tax law and net capital gains are taxed at 1/2 the rates imposed on other net income. Capital losses are not allowed as deductions in computing net income. [L. 1938, c. 511 (Tax Law, §§351, 358, subds. 4, 5, 6)]

(Initialed) E. H. Foley, Jr.

GLK:t  
1-25-40

JAN 16 1940

Secretary Morgenthau

Mr. Foley

During a hearing held last May before the TNEC on the general subject of investment and savings, under the auspices of the Securities and Exchange Commission, Mr. William R. White, Superintendent of Banks for the State of New York, testified on the general subject of legal investments for savings banks and trustees in New York.

His testimony related generally to the possibilities for expanding the so-called "legal list". Mr. White seemed to feel that there was some possibility for opening up the list but was unwilling to express any very definite ideas as to what, if anything, could be done. His testimony was quite brief and for the most part consisted in an explanation of the general rules applied in New York to the investment of bank and trust funds.

Mr. White pointed out that the banking law in New York was amended in 1938 to permit the State Banking Board to add to the list of securities in which savings banks could invest and that the Banking Board, in the year following enactment of the legislation, had added to the legal list debentures in an aggregate amount of in excess of \$500,000,000. The securities added were largely those of telephone companies, although two industrial firms were included. He stated that in his opinion there is a growing tendency to shift part of the emphasis from the underlying security to the credit standing of the issuing corporation, but indicated his opposition to adding stocks, preferred or common, to the legal list in New York at the present time, at least in so far as savings banks are concerned. He suggested that if a separate list were established for trustees consideration might be given to permitting such trustees to invest in stocks.

Because of the very limited nature of the testimony given there was little opportunity for members of the Committee to form much of a judgment about Mr. White, though I am informed he made a generally favorable impression.

(Initialed) E. H. F., Jr.

JJO'C.Jr/Lsw  
1-16-40

# CONFIDENTIAL

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## TREASURY DEPARTMENT

### INTER OFFICE COMMUNICATION

DATE January 16, 1940

TO Secretary Morgenthau

FROM Mr. Cochran

The foreign exchange market was fairly quiet today with the quotation for sterling moving off from 3.97-1/2 at the opening to 3.96-5/8 at the close. The volume of reported sterling transactions was £350,000 greater than that of yesterday, an increase which was partly accounted for by the offering of a £200,000 oil bill in the market.

Sales of spot sterling by the four reporting banks totaled £690,000, from the following sources:

By commercial concerns.....	£ 434,000
By foreign banks (Europe, South America and Far East).....	£ 256,000
Total.....	£ 690,000

Purchases of spot sterling amounted to £335,000, as indicated below:

By commercial concerns.....	£ 203,000
By foreign banks (Europe and Far East).....	£ 132,000
Total.....	£ 335,000

The following reporting banks sold cotton bills totaling £161,000 to the British Control at the official rate of 4.02-1/2:

£ 107,000 by the Guaranty Trust Co.
48,000 by the Chase National Bank
6,000 by the National City Bank
<u>£ 161,000 Total</u>

The rate for the guilder continued to recede, closing at .5319. The belga, which was also under pressure yesterday, recovered today to close at .1684-1/2.

The other important currencies closed as follows:

French francs	.0224-7/8
Swiss francs	.2242
Canadian dollars	11-7/8% discount

The Federal Reserve Bank purchased 30,000 Swiss francs for the Bank of Latvia. It also purchased 4,000,000 French francs and 80,000 guilders for the National Bank of Rumania.

# CONFIDENTIAL

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We purchased \$1,200,000 in gold from the earmarked account of the National Bank of Belgium.

The Federal Reserve Bank of New York reported to us the following shipments of gold:

\$ 991,000 from Mexico, shipped by the Bank of Mexico to the Federal Reserve Bank of New York, to be earmarked for account of the Bank of Mexico.  
421,000 from England, shipped by the Guaranty Trust Co., London to its head office at New York, for sale to the U. S. Assay Office for account of the Amsterdam Bank, Amsterdam.

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\$1,412,000 Total

On the report of January 10, 1940 received from the Federal Reserve Bank of New York, giving the foreign exchange position of banks and bankers in its district, the total position in all currencies was short the equivalent of \$21,493,000, an increase of \$1,395,000 in the short position. The net changes in positions are as follows:

COUNTRY	SHORT POSITION JANUARY 3	SHORT POSITION JANUARY 10	INCREASE IN SHORT POSITION
England	\$ 8,217,000	\$ 9,758,000	\$1,541,000
Europe	8,680,000	8,520,000	160,000 (Decrease)
Canada	4,000	197,000	193,000
Latin America	249,000	430,000	181,000
Japan *	2,455,000	2,206,000	249,000 (Decrease)
Other Asia	505,000	403,000	102,000 (Decrease)
All Others	12,000 (Long)	21,000 (Long)	9,000 (Increase in (Long Position))
Total			
	<hr/> \$20,098,000	<hr/> \$21,493,000	<hr/> \$1,395,000

\* Includes Korea and Manchuria

The London spot and forward prices for silver were both fixed at 22-3/16d, an advance of 7/16d. The U. S. equivalents were 39.64¢ and 39.44¢. Handy and Harman's and the Treasury's prices for foreign silver were unchanged at 34-3/4¢ and 35¢ respectively.

We made five purchases of silver totaling 325,000 ounces under the Silver Purchase Act. All of this silver was new production from foreign countries and was purchased for forward delivery.



TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE JAN 18 1940

TO Secretary Morgenthau  
FROM Mr. Foley

During a hearing held last May before the TNEC on the general subject of investment and savings, under the auspices of the Securities and Exchange Commission, Mr. William R. White, Superintendent of Banks for the State of New York, testified on the general subject of legal investments for savings banks and trustees in New York.

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Mr. White pointed out that the banking law in New York was amended in 1938 to permit the State Banking Board to add to the list of securities in which savings banks could invest and that the Banking Board, in the year following enactment of the legislation, had added to the legal list debentures in an aggregate amount of in excess of \$500,000,000. The securities added were largely those of telephone companies, although two industrial firms were included. He stated that in his opinion there is a growing tendency to shift part of the emphasis from the underlying security to the credit standing of the issuing corporation, but indicated his opposition to adding stocks, preferred or common, to the legal list in New York at the present time, at least in so far as savings banks are concerned. He suggested that if a separate list were established for trustees consideration might be given to permitting such trustees to invest in stocks.

Because of the very limited nature of the testimony given there was little opportunity for members of the Committee to form much of a judgment about Mr. White, though I am informed he made a generally favorable impression.

*F. N. F. L.*

JAN 16 1940

Dear Mr. Chairman:

I have your letter of January 8, 1940, relating to the summary of the tax recommendations received by the Department which was transmitted to you on January 4. I am glad to learn that you believe that this material will be of benefit to your Committee and I very much appreciate the kind sentiments which you expressed on the Department's work.

You requested information regarding the source of each suggestion, the opinion of the Department as to which suggestions are worthy of present consideration by the Committee, and the reaction of the Department to each of the suggestions submitted.

The problem of indicating the source of the multitude of suggestions which have been received is, of course, a large one, but we will undertake to supply you with this material as quickly as possible. To determine which of the suggestions not already included in the list of matters at present being studied by this Department together with the staff of the Joint Committee merit further consideration will take some time, but we will also undertake to furnish you with this information at the earliest possible moment.

The Treasury Staff will also be instructed to furnish you with a report on its reactions to as many of the taxpayers' suggestions as is practicable. Some of the proposals advocated, however, involve considerations of fundamental tax policy upon which a vast literature has already been written (for example, taxation of capital gains) and it would be impossible adequately to comment upon them within the limitations of time and space which the report requires.

Please feel free to ask for any further information on any of the suggestions in which your Committee is particularly interested.

Sincerely yours,

(Signed) H. Morgenthau, Jr.

Secretary of the Treasury

Honorable Robert L. Doughton,  
Chairman, Joint Committee on  
Internal Revenue Taxation,  
Washington, D. C.

ORIGINAL FORWARDED TO ADDRESSEE  
FROM OFFICE OF THE SECRETARY

*by hand 4:00 pm 1/16/40*

File to Mr. Thompson

C  
O  
P  
Y

Congress of the United States  
Joint Committee on Internal Revenue Taxation  
Washington

January 8, 1940

Dear Mr. Secretary:

This will acknowledge receipt of your letter of January 4, transmitting a summary of the tax recommendations and suggestions received by the Treasury Department in response to the general invitation which your Department issued to the taxpayers and their representative organizations and spokesmen.

I have examined with members of the staff the material submitted and am of the opinion that it contains much that will be of benefit to the Committee in the consideration of future tax legislation.

You emphasize that the recommendations contained in the summary do not purport to represent the views of the Treasury Department and, further, that the views expressed are, in the main, those of taxpayers with relatively large incomes and important business connections, for the reason that such persons are those most keenly conscious of tax problems and have the ability to make themselves effectively vocative. Moreover, you point out that the wider experience of these persons with the application and effect of our tax laws indicates that it is but natural that the greater number of suggestions for changes in our tax structure should come from them.

I heartily concur in your note of caution as my experience with hearings before Congressional Committees clearly supports your point. For these reasons, I suggest that it would be of aid to the Members of the Committee in helping them evaluate these suggestions if your staff would indicate the connection between the witnesses and the recommendations. For example, a suggestion from manufacturers of an article subject to an excise tax, that the tax on their product be repealed, might not warrant the same consideration as a similar recommendation from the general public.

In addition to information regarding the source of these suggestions, it would be of the greatest value to the Committee if your staff would indicate its reaction to each recommendation. Further, it would be desirable if an indication could be had as to whether, in the opinion of the Treasury Department, the

material contains any suggestions worthy of the present consideration of the Committee which are not already covered by the studies now being made by the Treasury Staff and the Staff of the Committee.

I commend your staff for the ably prepared summary of these rather voluminous recommendations.

Sincerely yours,

(Signed) R. L. Doughton

R. L. Doughton  
Chairman  
Joint Committee on  
Internal Revenue Taxation

The Honorable  
Henry Morgenthau, Jr.  
Secretary of the Treasury

January 16, 1940.

WHITE, WILLIAM R.

BORN: June 24, 1903.

COLLEGE: Bucknell 1926.

COLUMBIA LAW SCHOOL: 1929

EXPERIENCE: With Chadbourne, Stanchfield & Levy until August 1930; associate counsel of the State Banking Department from August 1930 to 1934 at which time he became deputy superintendent and counsel. Named Superintendent of Banks by Governor Lehman on January 8, 1936.

COMMENTS: Sam Klaus, Gibbs Lyons and Cyril Upham might be good sources with which to check on him.

January 16, 1940.  
2:41 p.m.

H.M.Jr: Hello.

Operator: Mr. Foley. Go ahead.

H.M.Jr: Ed?

Ed  
Foley: Yes, Mr. Secretary.

H.M.Jr: What have you done about that Indiana matter?

F: Well I'm over in Guy's office right now.

H.M.Jr: Oh!

F: And we're all here talking about it.

H.M.Jr: Right.

F: Guy called a meeting for half past two.

H.M.Jr: Oh, you're over on that now?

F: Yes.

H.M.Jr: Well I just wanted to make sure that you were holding the meeting.

F: Yes. Guy and Sullivan and Elmer and Phil Wenchel and Harold Graves and I are sitting here.

H.M.Jr: Oh!

F: Talking about it right now.

H.M.Jr: Ask Elmer whether he needs a good lawyer, tell him I'm not busy I'll come over.

F: O.K. (laughs) (aside: Wants to know if you want a good lawyer Elmer, he says he isn't busy he'll come over). Says he doesn't know a better one. (laughs)

H.M.Jr: All right. Well, you fellows can tell me about it tomorrow.

F: All right sir.

H.M.Jr: I just wanted to make sure you were working on it.

F: O.K.

January 17, 1940.  
12:14 p.m.

Operator: Go ahead.

H.M.Jr: Hello.

Gordon  
Rentschler: Hello Henry, how are you?

H.M.Jr: How are you?

R: All right, fine.

H.M.Jr: Gordon, who is the controlling factor in Pratt and Whitney?

R: Is what Henry?

H.M.Jr: Who is the controlling factor in Pratt and Whitney?

R: Pratt and Whitney, my brother Fred.

H.M.Jr: Your brother Fred.

R: Yes.

H.M.Jr: I mean he has the control.

R: Yes, well he - no the stock is very broadly -

H.M.Jr: No I meant as manager.

R: He's always been the very definite positive head of it.

H.M.Jr: Management.

R: And he hasn't been an officer for a long while and has taken no compensation from the company but on the 22nd, just because this thing is getting so big now, on the 22nd, when they have their meeting, he will again have himself elected chairman and be active in the company.

H.M.Jr: Well now seeing that I know you so well, I don't know your brother Fred, I was told that Fred was the boy.

R: Yes.

H.M.Jr: Is he older or younger than you?

R: He's younger, just two years younger.

- 2 -

H.M.Jr: I see. I wonder if he wouldn't come down and see me personally Friday morning.

R: Friday morning. Henry I'll see if I can get him. He went down to take his family to Boca Raton and to be there for a couple of days and then he's coming back, let's see, when is the 22nd.

H.M.Jr: Well now let's see, today is the 17th, 22nd is Monday.

R: 22nd is Monday. Now it may well be that I can get him in there Friday morning.

H.M.Jr: Well now wait a minute. I want to be humane. If he's got to be in Hartford on the 22nd, you see?

R: Yes.

H.M.Jr: Maybe he could stop, get here, stop off Sunday, and see me Sunday.

R: That may well be.

H.M.Jr: See what I mean?

R: Yes, I tell you what is the only complication he has and I'll check on that this morning. Don Brown, who has been President of Pratt and Whitney is very seriously ill at the Doctors' Hospital here in New York.

H.M.Jr: Oh!

R: And just quiet - just between you and me we had a preliminary operation in Fred's absence the other day.

And while we're going ahead with the second operation which is pretty serious, we want Fred back here when that happens because we want him to handle it with Don's family because I don't know the family intimately.

H.M.Jr: Well I have something in mind which is a little bit different to the one they've been talking -

R: Yes.

H.M.Jr: With the Allied Purchasing Commission.

- 3 -

R: Oh fine. Well now Henry, you will be available in Washington Sunday?

H.M.Jr: Well yes, I - I'd rather not, but if - if it's -

R: But if he's coming through for - Saturday would suit you better than Sunday.

H.M.Jr: Yes, or I can make myself available the latter part of Sunday afternoon.

R: Fine. Well now I'll give Fred a ring, and I'll first call the hospital and see exactly what the plans are there.

H.M.Jr: Yes.

R: And then I'll give Fred a ring and I'll call back to you Henry.

H.M.Jr: I'm available either Friday morning or the latter part of Sunday afternoon.

R: Friday morning or Sunday afternoon.

H.M.Jr: See?

R: All right Henry, fine.

H.M.Jr: And, but I want a heart to heart talk because I'm not -

R: I see. All right Henry, fine.

H.M.Jr: Satisfied, and the President isn't satisfied.

R: Yes.

H.M.Jr: See?

R: All right. Well I'll get Fred right away.

H.M.Jr: Righto.

R: Henry, you're all right.

H.M.Jr: Oh I'm fine.

R: We didn't go any further on these machine tools you and I talked of last week.

H.M.Jr: Yes.

- 4 -

R: But we'll let that wait until next week some time.

H.M.Jr: Yes, well look -

R: Until we get more definitely straightened out with what the French and British really have in their minds.

H.M.Jr: That's right.

R: What they really need to do - I told them yesterday Henry that what they must do, determine from the other side what they really want, and then let us show them how they can get it.

H.M.Jr: That's all correct but - there's something which I have in my mind which I want to talk with your brother.

R: I see. Well now you and Fred, I'll fix it up so you and he can sit down and have plenty of time to talk together.

H.M.Jr: And you let me know sometime today.

R: Yes indeed I will. I'll call him right away.

H.M.Jr: Whether it will be Friday morning or Sunday afternoon.

R: Fine. I'll call him right away Henry.

H.M.Jr: Thank you.

R: All right.

H.M.Jr: Thank you. Goodbye.

R: Goodbye.

January 17, 1940.  
2:55 p.m.

H.M.Jr: How are you Ben?  
Ben  
Cohen: All right. I'm sorry you weren't feeling so well yesterday.

H.M.Jr: What do you mean?

C: Well I, I phoned you and you had gone home early, and Ed told me that you weren't feeling just as well as usual.

H.M.Jr: Oh no, I was all right. I had been up in the air and I was a little air sick.

C: What's that?

H.M.Jr: I had had an aeroplane trip and I was a little air sick.

C: Oh, well, I know, you get down from those and it takes two or three hours to get over them.

H.M.Jr: That's right.

C: I only wanted to phone you and felicitate you on your happy statement about the Associated Gas Trustee.

H.M.Jr: Well Ed told me - why are you so excited?

C: Well I only thought the SEC ought to go into that and not - half way.

H.M.Jr: I see.

C: That is after all if they try to tell the court who to appoint as an individual then it becomes a patronage matter and they haven't much more standing than the court.

H.M.Jr: That's right.

C: That is if it's a question of a fellow that the Commission relies on, a fellow that the court relies on, the court has the last word. While on the other hand if it's something that the Commission itself really takes responsibility for then they have a right to say who should go in because they're responsible for his action.

H.M.Jr: Well I know they're very hesitant and loath to do it, but I don't see why they shouldn't do it, the SEC.

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- C: Well I feel the same way and that's why I was so eager to congratulate you because it shows the Treasury has much more guts than they have.
- H.M.Jr: Well with all due modesty that doesn't surprise me. (laughs)
- C: (laughs)
- H.M.Jr: Well at least I can't share my fears with anybody, I've just got to say I either do it or I'm afraid to do it.
- C: Well that is if we suggest someone we're responsible in a way, anyway and so I think it's much better really that the court doesn't have to name them, but I think it's much better if the court wants to cooperate with the Commission for them to name the Commission.
- H.M.Jr: Just to switch a minute, and I've been thinking - I appreciate your calling me while I was talking to you. You're on fairly friendly terms with Eccles aren't you?
- C: Yes, as far as I'm aware.
- H.M.Jr: Well I'm going to talk it over with Ed. I think I'm going to ask him to tell you the story we're at right now, somebody has got to talk to Eccles about this Bank of America business.
- C: Uh-huh. All right.
- H.M.Jr: See? Would you feel free to do it if you felt that what we and the rest of the agencies were trying to do was right, I mean -
- C: I'd be glad to. The only question is if I'm the best person to do it.
- H.M.Jr: Well you're the only person I know who could do it who is close to him.
- C: Do you think I'd be better than Lauch?
- H.M.Jr: Why not explain it to - yes, because I said something one -
- C: He might be embarrassed doing it anyway.

- 3 -

- H.M.Jr: Well I once said something to Lauch, and he said, "Well remember I'm on a leave of absence from the Federal Reserve". See.
- C: Well I'll be glad to. And while we were talking on that I don't know, I read in the paper you know, of the fellow in San Francisco -
- H.M.Jr: Whose name will be unmentioned.
- C: Yes. Threatening to become a state institution.
- H.M.Jr: Yes.
- C: Offhand I don't see either that ousts you in any way of jurisdiction or of your responsibility.
- H.M.Jr: That isn't the thing right now that's worrying us. The thing that's worrying us right now is that Giannini -
- C: Yes.
- H.M.Jr: Has formally asked the Federal Reserve to make an independent bank investigation, see?
- C: Yes.
- H.M.Jr: And the SEC, FDIC, the Comptroller and ourselves all don't want him to do it because there's absolutely no reason and the Federal Reserve in their whole history have never made an independent audit, and for them to do it now well it would be just terrible, see?
- C: Yes.
- H.M.Jr: And particularly inasmuch as the SEC, their whole case rests on the examination of the bank made by the Comptroller, and if there's any doubt cast on that it just leaves the SEC high and dry.
- C: Surely.
- H.M.Jr: It's not so bad for us but it's just not feather to a cocked hat.
- C: Well I mean I don't know - in this particular, whether there's any reason for thinking that the Reserve is superior to the Treasury. The practice

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of having several bodies independent of one another going over the same grounds is not good administration to say the least.

- H.M.Jr: Well not only that, but it casts doubt on us, you get the whole story. I can't believe that they're going to do it, but if it does - I mean if they do do it, we had one meeting with them last week and now that they've got formal notice the boys have called all the agencies together for another meeting tomorrow with Eccles, you see?
- C: Yes.
- H.M.Jr: To lay the thing before him once more why he shouldn't do it.
- C: Yes.
- H.M.Jr: And I can take it, see?
- C: I know.
- H.M.Jr: But the SEC can't, and neither can the President of the United States.
- C: That is the point, I mean, if one agency takes upon itself with - in some respects, much less clear authority to act in a way that it looks as if they're questioning the act of another department. Simply it causes confusion and gives ammunition to the enemy, because it creates a feeling that we don't trust ourselves.
- H.M.Jr: Well and another thing is for over twelve months the Federal Reserve wouldn't even discuss this case with us, because they said it would come before them eventually and they mustn't be biased. Now when we've taken this action they suddenly get interested and they're making life very difficult for us. I mean the thing stinks to heaven from Eccles' standpoint.
- C: I know. I mean I've heard from different sources.
- H.M.Jr: And it makes all of these ugly rumors seem as though they might be true.
- C: I know.
- H.M.Jr: And all of that again reflects on the President.

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- C: I know. And the delays unnecessarily aggravates the situation. If the thing comes to a head promptly then there's - it may hurt some people and - but it's out and forgotten. This way it gives a good deal of credence to the idea that someone is being persecuted. You don't know just what it is.
- H.M.Jr: Now my mail from California is very interesting. They're all giving me a pat on the back. A good many of the letters are anonymous saying at last somebody has the courage to go after him and how much they've lost and how Giannini has cheated them and so forth and so on. I've yet to get a letter that hasn't praised me on that little statement I made last week about wanting to protect the depositors' interest.
- C: Yes.
- H.M.Jr: And the letters come - so far all of my mail has been favorable, say go at it, go to it, it's high time.
- C: There's no question because with a situation like that or with the Associated, the more one lets him around the more grief is piled up for some one.
- H.M.Jr: Well I'm going to call Ed immediately. I'm going to tell him to get in touch with you and give you the story.
- C: All right.
- H.M.Jr: And I'm going to ask him whether things - well if there is a meeting tomorrow maybe invite you and ask you to be an observer.
- C: Whatever you think would be helpful.
- H.M.Jr: Righto. And then, doing this first for the President, second for me.
- C: Yes. Well I'll be happy to do anything that you think helpful.
- H.M.Jr: Thank you.
- C: All right Henry.
- H.M.Jr: Goodbye.
- C: Goodbye.

January 17, 1940  
3:53 p.m.

Robert  
Wagner: Hello.

H.M.Jr: Hello, Bob?

W: Hello, Henry. How are you?

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

W: I've been trying to get you and you trying to get me and so it goes.

H.M.Jr: And so it goes.

W: I had the -- just a moment ago I had Senator Guffey in here - you know he's -- why don't you renominate him?

H.M.Jr: For what?

W: Senator.

H.M.Jr: (laughs) I happen to live in New York state.

W: Yeah. Say, Henry, Steagall talked to -- said he talked to you. He wasn't so sure that was wise, and maybe he's right; I don't know - I'm not sure about it but maybe it would be better for us to talk it over with a couple first. What do you think?

H.M.Jr: I think if I could sit down with you and Glass and Steagall it would be fine.

W: Well .....

H.M.Jr: Just the three of you.

W: Yeah. Well, he's -- he'll be back next week. He went down to Alabama.

H.M.Jr: I see - where the cotton grows, huh?

W: Huh?

H.M.Jr: Where the cotton grows.

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W: Where the cotton grows and where he's -- says he's got to make a couple of speeches for Bankhead for President.

HMJr: I see.

W: So.....

HMJr: Well, when he gets back let's do it.

W: Yeah. Now the other thing is this: Carter and Nye -- he -- Carter insists on me going with him -- are going to see the President tomorrow about -- I think that this bill that the President vetoed, and I'm not much of a banker fellow, of this interlocking director.....

HMJr: Yes.

W: .....I think it was a little premature. I think they really need a little more time, Henry.

HMJr: I see.

W: I wondered whether you had a chance to look into it yourself.

HMJr: No, I haven't.

W: Because they gave me a long list of fellows and they're going to -- oh, they resign and die and there's none -- interlocking directors can take their place but some of them they're losing, they claim, and smaller banks too. None of the large banks are very much affected.....

HMJr: No.

W: .....are losing some very good directors they'd like to hold.

HMJr: Oh.

W: And so we wanted to have the bill re-introduced; As a matter of fact, Carter re-introduced it.....

HMJr: Yeah.

W: .....and give them about four more years. Now,

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we're going to -- I thought we ought to do nothing in the committee until the President, who vetoed it.....

HMJr: Yes.

W: .....at least said he'd reconsider it again.

HMJr: Yes.

W: And have any of them -- I told them they ought to have a talk with you. Have any of them talked to you yet?

HMJr: You're the first man.

W: Yeah. Well, they'll come up.

HMJr: All right.

W: They'll come up to see you and talk to you about it.

HMJr: Well.....

W: The only thing is - I didn't want to even do that much, although I -- I think the legislation is reasonable. If the President says "thumbs down" I won't do anything about it.

HMJr: Well, I'll tell you what I'll do - let's ask -- I'll ask my boys to take a look at it and after I've done it I'll get in touch with you again.

W: Yeah. What -- what -- last year we didn't get the information which they've given us since. They've collected a number of banks all through the country.....

HMJr: Oh.

W: .....that would be affected - some 500 and some odd. And it's -- in some cases I guess they're right about it. It's the local -- the big fellow in the locality who helps them very much would be disqualified and if they lost him it would be a serious loss. You know how these people are, but I think there's -- there's some merit to it and

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what I thought tomorrow that maybe, suggest to the President they might talk it out with you.

H.M.Jr: All right with me.

W: And if it's - and if it's all right then why we can go on.

H.M.Jr: Bob I'll be delighted to look into it.

W: All right Henry.

H.M.Jr: And after I've done it I'll give you a ring.

W: Fine Henry.

H.M.Jr: Thank you for calling.

W: All right.

H.M.Jr: Goodbye.

January 17, 1940.  
4:05 p.m.

Operator: Go ahead.

H.M.Jr: Hello.

Captain  
Collins: Mr. Secretary?

H.M.Jr: Talking.

C: P-36 completed.

H.M.Jr: Ha, ha, ha.

C: No chance at all.

H.M.Jr: Well then, I don't think we'll sell any to the Finns.

C: No, it doesn't look that way.

H.M.Jr: No - (laughs) We'll give them some Newbergs to dye.

C: Yes sir, if we have to.

H.M.Jr: All right.

C: All right, sir.

H.M.Jr: Thank you.

C: You're welcome sir.

January 17, 1940.  
9:20 a.m.

Captain  
Collins: Good morning sir.

H.M.Jr: Hello Collins.

C: Mr. Secretary, the meeting yesterday afternoon did not adjourn until after five.

H.M.Jr: Yes.

C: Now it is not going to be possible to have the information on the planes this morning at all. They are under commitments to deliver that tonight and Martin will probably deliver alongside the clipper tomorrow morning, so I wanted to get that to you in the event that might effect the meeting the meeting at eleven o'clock.

H.M.Jr: No, no, no. That isn't it. It's the whole lay out.

C: I see.

H.M.Jr: It's the whole lay out, you see. This is what, I'm putting a memorandum on the President's desk, I've written it out, I'm going to have it typed, you see?

C: Yes sir.

H.M.Jr: And you can have this in line. There's three things, one, what are the needs of the Army and Navy for '40 and '41, you see?

C: Yes sir.

H.M.Jr: Two, what if anything can they spare, planes and engines, to the allies now.

C: Yes sir.

H.M.Jr: And then three, discuss the allied purchasing program as far as it has gone.

C: Yes sir.

H.M.Jr: And fourth, can we license a company to manufacture radial air-cooled engine in the heart of United States.

C: That's a very comprehensive program tied in tight too, isn't it?

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H.M.Jr: Well I've written, I wrote that out late last night.

C: Yes sir.

H.M.Jr: I'm having it typed.

C: Yes sir.

H.M.Jr: And that's the thing I wanted to put up to you gentlemen.

C: Yes sir.

H.M.Jr: Now just for your own information I suggested that the Secretary of the Army and Navy be there and the word came back that the only cabinet member who was to be there was myself.

C: Yes sir.

H.M.Jr: Quite a compliment.

C: Yes, sir, it certainly is and I'm very happy over that too, sir.

H.M.Jr: Well, but I definitely suggested the Secretary of War and Navy.

C: Yes sir.

H.M.Jr: There you are.

C: Yes sir.

H.M.Jr: Now I suggest that you come over here at quarter of eleven and pick me up, and we can talk a little bit and go over together.

C: Aye aye sir, I'll be there at ten forty-five.

H.M.Jr: Righto.

C: Thank you sir.

11.30 P.M. Jan 17, 1940

2211 THIRTIETH STREET  
WASHINGTON, D. C.

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memo for F.H.R.

What are the needs of  
our Army + Navy for 1940 + 1941  
aviation.

What can we spare in  
planes + engines to allies  
now.

Discuss allies purchasing  
program.

Can we license company  
manufacture radial air  
cooled engine in heart of U.S.

January 17, 1940

CONFIDENTIAL MEMORANDUM FOR THE PRESIDENT.

Suggestion for an agenda.

I. What are the needs of our Army and Navy in the field of aviation for 1940 and 1941?

II. How many airplanes and engines, if any, could be diverted to the French and English for immediate delivery?

III. Ask for an explanation of the French and English proposed buying program.

IV. Would it be possible to have Pratt-Whitney or Curtiss-Wright license an experienced Company to manufacture their engines, the company to be located somewhere in the Mississippi Valley, as both Pratt-Whitney and Wright are on the Atlantic Coast?

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# TREASURY DEPARTMENT

PROCUREMENT DIVISION

WASHINGTON

January 17, 1940

## MEMORANDUM

At a meeting in the President's office at 11 o'clock this morning, in addition to the Secretary of the Treasury, there were present General Brett, General Yount, General Gregory and Colonel Burns of the Army; Admiral Spear, Admiral Towers and Captain Kraus of the Navy; and the Director of Procurement.

The President inquired of the Director of Procurement as to the status of the Anglo-French program. He was informed that the program presently being surveyed provides for 13,675 engines to be supplied by Allison, Wright and Pratt & Whitney by October 1, 1941, at an estimated cost of \$214,000,000 with approximately \$65,000,000 added for expediting fees, but that similar information concerning airplanes was not at the moment available. The President inquired as to the annual production of motors and was advised that by the end of 1940 there would have been produced 24,000 engines, which number, after meeting the Army and Navy requirements, will be insufficient to meet the 13,675 engines required by the Allies. He commented on the fact that the large air-cooled motor plants were located on the coast, with the Allison plant at Indianapolis, and asked the opinions of the Army and Navy representatives as to the advisability of the establishment of any additional facilities in the Mississippi Valley, rather than the expansion of existent seaboard plants. General Brett concurred in the advisability of the establishment of any additional engine plants inland but pointed out that, time being the essence of the Allied program, he believed that much faster deliveries could be made of engines by the extension of existent plants rather than the establishment of an entirely new plant. In this Admiral Towers concurred.

The President then inquired as to the possibility of utilizing some of the smaller engine manufacturing plants for the production of engines of lower horsepower presently being used in trainers. Both the Army and Navy representatives felt that such action would result in increasing the output of existing plants of combat engines (1000 HP or more).

The President further inquired as to the possibility of diverting some engines from existing contracts of the military departments with particular reference to the immediate diversion of spares and was informed that such action would definitely slow up the programs of both the Army and the Navy now but that deliveries might be delayed toward the end of their programs and deliveries to the Allies correspondingly expedited. It was roughly estimated that this might amount to 500 engines.

The President stated that he felt that those present understood the necessity for expediting in every way possible deliveries to the Allies, that he wanted them to have his views on the subject and that the matter, if necessary, would be taken up

again at a later date.

The Secretary stated that he would like to expedite the release from Customs of a Spitfire plane and asked if there were any objections on the part of the Army to his taking action to that end, the plane to be delivered in Canada. To this the Army agreed.

The meeting adjourned at 12:10.

  
Director of Procurement

January 17, 1940

3 p. m.

Present:

Mr. Plevin  
Mr. Purvis  
Col. Jacquin  
Capt. Collins  
Mrs. Klotz

HM, Jr: What was this about Monnet's daughter going over?

Mr. Plevin: You see, he had a reservation. He had left his daughter here before the war and he wanted her to come back and he had sent the Governess to fetch her.

HM, Jr: I see. And when do you leave?

Mr. Plevin: We have to be at 6:15 a. m. at Baltimore airport tomorrow morning.

HM, Jr: As you most likely saw in the papers, we met with the President and the head of the Army and Navy Air Corps and out of that came this possible suggestion. I don't know whether you gentlemen are going to buy any more ships for training purposes. But if you do -- and that includes Canada .....

Mr. Purvis: Yes.

HM, Jr: ... they felt that plants like Lycoming could make engines up to 550 horsepower and if you were going to order any engines for training purposes with power up to 550, plants of that nature could give you fairly prompt delivery with possibly a little help and that will put no more work on the companies that you are counting on. I don't know whether you have in mind ships for training purposes, but I understand that Lycoming makes 220 and 550. They say it is a good engine.

Mr. Purvis: Yes. I think as far as Canada, it has its complement with an order we just placed with the North American Airplane Company. Quite a big contract.

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HM,Jr: You don't know where you are getting your engines?

Mr. Purvis: No. I had not heard that. I thought Pratt Whitney, but I am not sure.

Capt. Collins: I think so. Pratt-Whitney 450. That's what they have been using on the trainers.

HM,Jr: Would it be even too late possibly to switch?

Mr. Purvis: That contract was passed on the 17th of November.

HM,Jr: Then that's an old one. Anything in the future you gentlemen can take up to 550?

Capt. Collins: Lycoming has a 625.

HM,Jr: Anything up to 625. We did not have a chance to look at any others.

Capt. Collins: Jacobs was another.

Mr. Purvis: And Jacobs is another good one?

Capt. Collins: Very good one for primary trainers.

HM,Jr: And the other thought, which is one I mentioned to you last night, is this: in looking over the figures I notice that out of this proposal you are proposing to give 3,000 to 3,500 to Allison. Is that because you really want Allison or because you can't get anything else?

Mr. Plevin: Will you allow me to translate for Col. Jacquin?

HM,Jr: Please.

Mr. Plevin: At first we were not too desirous to have as many Allison motors, but now from what we hear of certain requirements we are quite pleased at this time to have them.

HM,Jr: Let me give you the thought we had in our

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mind. Instead of General Motors doing all that they say they are going to do for you, or Pratt Whitney or Wright, the thought I had was that we go to Pratt Whitney or Wright, whichever engine you think you have, and say "Now, give a license to make that engine to Allison and let Allison make whichever you people want the most, Wright or Pratt Whitney, in the Allison Plant and let General Motors concentrate on building that engine in their plants.

Mr. Plevin: We could not answer outright to such a proposal because on the basis of the technical information that Colonel Jacquin has been receiving, we really require the two types of plane, require Pratt Whitney and the Wright, because they are not the same horsepower. One is 1065 horsepower while the other is 1600 horsepower and from the conversations we had before reaching the present opinion, we came to the preference that we would get quicker results in having certain types, but if you wanted to have an answer on this situation we will be glad to give it to you after we are in France, because it is difficult.

HM, Jr: I am just raising it, because if General Motors is going to expend so much energy and give so many technical people to Pratt Whitney and Wright, they could do it also for themselves and it would be just a question of saying while we want -- whatever the type is -- and you could get a license to make Allison in their own plant, they could make two different kinds of Wright engines, but if they could make one and concentrate on one in the Allison plant you would have -- I mean, I was thinking, I was just thinking of General Motors, because if they have tools to make Allison, they also ought to have the tools to make the others.

Col. Jacquin: You see, I think while we are very pleased to know that you would speak to the people for a license or something like that, but I feel that now is not the time to do that. I think we must go, in England and in France, to know exactly how we work -- the partition between the bombers and pursuits -- and at that time we will know better how much Pratt Whitney we would require, so I think it is better to say that to you a little later when we have been to France.

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HM, Jr: I don't know whether we can get Pratt Whitney to give a license. I don't know whether Allison would accept it if they could get it. But I wanted you to know that both the President and I would make the effort if you felt that would give you what you want.

Col. Jacquin: We are very pleased to know that.

HM, Jr: In the very quickest manner.

Mr. Plevin: We thank you very much, Mr. Secretary.

Mr. Purvis: And I think General Motors, as far as our experience with them goes, would bend over backwards to do what was best for the program, because the disposition has been to do that.

HM, Jr: Well, up to Sunday you told me that you did not want Allison because you were afraid of it.

Mr. Plevin: Yes, but you see since Sunday we had one of our best men arrive, who brought us new information.

HM, Jr: An aviator?

Mr. Purvis: That's the man who called on me.

HM, Jr: What's his name?

Mr. Purvis: Zigler. A young fellow, just arrived.

HM, Jr: Do you mind telling me what he said?

Col. Jacquin: He said he was very pleased with the P-36 until the new Messerschmitt came on the front and the new Messerschmitt is so fast a ship the P-36 can't join it -- many times the plane speed of the P-36.

HM, Jr: A twin engine?

Mr. Plevin: The new Messerschmitt, single engine.

Col. Jacquin: And now they think they must have something quicker than the P-36.

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HM, Jr: I see. In other words, the Germans now have a single motor fighter.

Col. Jacquin: Yes; very quick. It is faster than the P-36 and manouevers better.

HM, Jr: Does this man speak English?

Col. Jacquin: Oh, yes. He is a very nice man.

HM, Jr: Could I see him?

Mr. Plevin: He will be here during the absence of Colonel Jacquin. He will be in charge of the French Air Mission.

HM, Jr: What's what made you change since Sunday?

Mr. Plevin: Yes.

HM, Jr: Then naturally you want the P-40.

Mr. Plevin: More than ever.

HM, Jr: With the Allison motor.

Mr. Purvis: This thing changes so fast.

HM, Jr: Because Sunday -- you see, I have been trying to think how I could get you something else.

Mr. Plevin: But you see Mr. Zigler arrived here only Monday and he was bringing with him the results of his experiences of the last few weeks on the front.

HM, Jr: Well, you know. Then the other thing, there is no use trying to oil on to Allison another motor if you .....

Mr. Purvis: .. not if it has changed to that extent.

HM, Jr: But I do think I would like you to send for the Jacobs people and the Continental people of Wisconsin and the Lycoming and just see what they have.

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Mr. Purvis: As to whether their parts could be adapted to the program in general.

HM, Jr: Yes. The possibility of licensing them or what they have got.

Mr. Purvis: As engine makers.

HM, Jr: What else?

Capt. Collins: The Ranger, but that's experimental.

HM, Jr: I am not thinking of a motor, but the possibility of licensing to make a successful motor like the Wright or Pratt Whitney. I would send for just as many as are making airplane engines and look at them as a possibility.

Another thing, if you are going back -- as Secretary of the Treasury I hate to spend money, and we have this so-called Spitfire plane in storage in Customs and our people -- Army people -- have asked -- this is British business -- won't they please re-export this plane to Canada so we can all take a look at it.

Mr. Purvis: Haven't they done that?

HM, Jr: Nothing has happened.

Mr. Purvis: Good heavens! I gave instructions.

HM, Jr: We really would like to see that Spitfire exported to Canada. Then we can all take a look at it.

Mr. Purvis: I will arrange it this afternoon. I am sorry it has not been done. The Army feel that way?

HM, Jr: They told the President so today and the President instructed me to go ahead with it. As I understand it, our Army has communicated with the Air Attache of the British Embassy and said they would like to see it re-exported to Canada, and nothing has happened.

Mr. Purvis: I understood it was done.

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HM, Jr: No. The Commissioner of Customs told me about it this morning.

Mr. Purvis: I am sorry. I will attend to it.

HM, Jr: That's another exhibition that we are still a Democracy.

Is there anything that you gentlemen want to ask me before you sail?

Mr. Plevin: No, Mr. Secretary, because we think you have done so much there is nothing that could be done. We had a very good meeting yesterday with the airplane makers and they are prepared to bring into the scheme all the distant factors, so we think if it is done it will meet what the President has asked us to do in distributing the work.

Mr. Purvis: Said it was 2200 manufacturers.

Capt. Collins: And sub-contractors.

HM, Jr: When you see Mr. Bullitt and Mr. Monnet, give them both my best regards.

Mr. Plevin: I will be glad to do so.

HM, Jr: And you will be back, both of you gentlemen?

Mr. Plevin: Colonel Jacquin will be back very soon.

Mr. Purvis: And you too, I hope. His visit has been very valuable.

oOo-oOo

## TREASURY DEPARTMENT

WASHINGTON

January 17, 1940.

MEMORANDUM FOR THE SECRETARY:

The airplane which was landed in New York and put into public storage shortly after the Neutrality Proclamation is still awaiting disposal. The storage charges are running along and if some disposal of this airplane could be arrived at, it would be desirable.

Basil Harris.



OFFICE OF  
COMMISSIONER OF INTERNAL REVENUE

TREASURY DEPARTMENT  
WASHINGTON

100

January 17, 1940.

Memorandum for the Secretary:

Referring to your recent request, this memorandum relates to the interest displayed by former Under Secretary John Hanes in several major conspiracy cases perfected in the summer of 1938, involving some 76 defendants, charged with violating the internal-revenue laws relating to intoxicating liquors in Wilkes County, North Carolina.

Some time in March or April, 1939, Mr. Hanes called Mr. Berkshire to his office and told him, in substance, that a number of the most prominent citizens in Wilkes County had been indicted in these cases. He criticized the methods used by the agents who conducted the investigation, stating, in effect, that some of the defendants had been induced to re-enter the liquor business on account of the attractive offers these agents were making to purchase liquor; that the investigations had been handled in such manner as to cause the arrest principally of democrats; and that the case had been perfected at the instigation of Federal Judge Hayes (Republican) for political reasons. Mr. Hanes went on to say that the people in Wilkes County were so aroused that if Judge Hayes imposed heavy penalties in these cases personal harm might come to him.

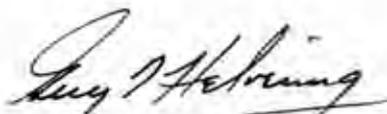
Mr. Berkshire told Mr. Hanes that similar complaints previously had been received and after looking into the matter he had determined that the basic undercover work had been done by an officer unknown and unacquainted in the County who had purchased spirits in quantity from every violator who desired to sell without knowing anything about their politics; and that these cases were initiated because conditions in the county were such that the citizens requested the Bureau to take some action. He also informed him that the investigation was completed and the reports had

- 2 -

been transmitted to the United States Attorney; and that the question of criminal prosecution was one for the determination of the Department of Justice.

Subsequent to this conversation, on May 11, 1939, Mr. Berkshire received a telephone call from Mr. McReynolds, who requested him to be in your office at a given hour on that afternoon for the purpose of discussing these cases. At this conference Mr. Berkshire stated to you, in Mr. Hanes' presence, the Bureau's position in connection with the investigation and prosecution of these cases, as outlined above. At the conclusion of his remarks, you dismissed the matter with the statement that you felt the Bureau had done a good job.

The first of these cases went to trial on May 24, 1939, and resulted in the conviction of 26 of the 35 defendants by a jury. The principal defendants in the other three cases then entered pleas of guilty.



Commissioner.



OFFICE OF  
COMMISSIONER OF INTERNAL REVENUE

ADDRESS REPLY TO  
COMMISSIONER OF INTERNAL REVENUE  
AND REFER TO

TREASURY DEPARTMENT  
WASHINGTON

102

JAN 17 1940

MEMORANDUM FOR THE SECRETARY:

You have requested a report concerning specific cases pending with the Bureau of Internal Revenue, in connection with which the Under Secretary has had direct contact with the taxpayer, or the authorized representative of the taxpayer. The following examples have been gathered from the entire Bureau organization, most of which, however, related to matters within the jurisdiction of the Income Tax Unit, or of the Field Divisions of the Technical Staff under the decentralization procedure.

The cases are presented under two Groups: first, those in which the Under Secretary appeared to have a particular interest, as evidenced by his granting and conducting conferences with the taxpayer and Bureau representatives present, irrespective of whether or not the decentralized procedure was applicable, and by expressing definite opinions, oral or written, as to the merits of the issues; and, second, cases in which the Under Secretary granted interviews with the taxpayer, without the Bureau representatives being present, and thereafter referred either the taxpayer or the controversy to the Bureau. In addition to the two groups, above mentioned, there were a large number of instances referred to the Bureau more or less as a matter of routine.

  
Commissioner.

JAN 17 1940

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Wm. C. T. Edrington  
Commissioner.

ARM  
18-40

GROUP I

Fisher and Company, Incorporated,  
Detroit, Michigan.

1929, 1930 and 1932.

Senior Investment Corporation,  
Detroit, Michigan.

1930 to 1933, inclusive.

After receiving the Commissioner's final offer to settle the tax liability of both cases for the sum of \$4,737,583.70, inclusive of interest, the taxpayers arranged a conference in Mr. Hanes' office for 10:00 o'clock April 20, 1939. Participating in the conference were Messrs. Fred and Charlie Fisher for the taxpayer and Messrs. Hanes, Wenchel and Reed for the Government. After considerable discussion of the issues involved and an expression of opinion on the part of the Fishers that \$3,150,000.00 was ample to settle the Government's entire claim, Mr. Hanes suggested that if the taxpayers were willing to split the difference between that figure and the amount proposed by the Commissioner and submit to him an offer to settle by the payment of approximately \$3,943,000.00, he would transmit the same to the Commissioner with his recommendation that it be accepted.

Before leaving to consult counsel, however, the Fishers were informed by Mr. Hanes that the responsibility for settling the case rested with the Commissioner and that while he would recommend acceptance of the offer such recommendation actually amounted to his approval of the settlement in the event the Commissioner should decide to accept it. Mr. Hanes added that if he were in the position of the Commissioner he would place considerable reliance upon the advice of Technical Assistants and that inasmuch as one of the Technical Assistants was then present he (Mr. Reed) might probably be willing to express an opinion at that time. Mr. Reed agreed and stated that he would, without hesitation, recommend to the Commissioner that he reject the offer if submitted.

After the departure of the Fisher Brothers and a further discussion of the case by Messrs. Hanes, Wenchel and Reed, Mr. Hanes instructed Mr. Reed to call the Commissioner immediately and inform him of just what occurred at the conference and explain the proposal of settlement which he had suggested and which the Fisher Brothers might submit as an offer. Mr. Hanes also stated that he expected Mr. Reed to convey to the Commissioner at the same time his personal recommendation concerning the acceptance of such an offer should it be made.

- 2 -

During the afternoon of the same day Mr. Hanes called the Commissioner and stated that the taxpayers' representatives were in his office and wished to submit the offer of settlement suggested by Mr. Hanes which he (Mr. Hanes) thought should be accepted. The Commissioner did not concur in Mr. Hanes' opinion and so stated over the phone, whereupon Mr. Hanes asked that he grant the representatives a further hearing. The hearing was subsequently held and resulted in the closing of the case by acceptance of the offer originally proposed by the Commissioner.

WILLIAM V. GRIFFIN

William V. Griffin, New York, New York. Year - 1935, Income Tax Liability. Pending before Board as Docket No. 98077. Charged to New York Division, Technical Staff.

The statutory notice of deficiency was mailed January 21, 1939. Prior to March 6, 1939, the Head of the Technical Staff in Washington was advised orally through the late Deputy Commissioner Kirk to grant a conference before the New York office of the Technical Staff within the so-called 90-day period. The Head was informed that if the New York office did not grant the taxpayer's contentions, the Under Secretary desired to arrange a conference in his own office. For this reason the Head directed the New York Division to assign the case "to the very best man available in your Division". The conference was arranged in the New York office but no satisfactory basis of closing was reached.

On April 19, the Under Secretary addressed me as follows:

"Enclosed herewith is a letter which I have received from Mr. E. Barrett Prettyman and a copy of my reply. Will you arrange for a hearing in my office some day next week convenient to the men you designate. It seems to me this is a matter we should be able to settle without going to the Board of Tax Appeals. If you will notify my secretary, we will call Mr. Prettyman."

The conference was held in the Under Secretary's office on April 27, 1939, there being present the taxpayer, Mr. William V. Griffin; former Assistant Secretary Hewes; E. Barrett Prettyman; T. C. Mooney, then Head, New York Division, Technical Staff; Eldon O. Hanson, Counsel, New York Division, Technical Staff; A. E. Marrs, Head, Technical Staff; and several others. At this conference the case was thoroughly discussed. The Under Secretary stated that in his opinion the Staff's position was based upon a premise contrary to what the taxpayer actually did. This statement was made in the presence of the taxpayer and his counsel. After taxpayer and counsel departed, the discussion continued and the Under Secretary stated definitely that he believed the taxpayer would win the case before the Board and that we should not require him to litigate.

William V. Griffin, Continued.

The conference was again resumed the following morning between Messrs. Hanes, Mooney, Hanson and Marrs. At this time the Under Secretary again stated that he disagreed with the Bureau's position and that the Bureau would lose the case.

Briefly, the controversy grows out of an attempted tax avoidance plan whereby the taxpayer realized an actual cash profit of about \$516,000.00 on the sale of securities, but reported for tax purposes a loss of about \$114,000.00.

On June 6, 1939, I forwarded a memorandum to Under Secretary Hanes, copy of which is enclosed, containing my conclusion "to allow the case to remain with the New York Division of the Technical Staff for handling under the usual procedure". In this memorandum I gave my tacit approval, after careful consideration, to the effect that if a proposition of settlement were submitted in the approximate sum of \$64,000.00, plus statutory interest, I would not be opposed to such a closing of the case. No such proposal has been submitted by the taxpayer. The case is still pending in the New York Division.

JUN 6 1939

## MEMORANDUM FOR UNDER SECRETARY HANES:

In re: William V. Griffin,  
New York, New York.

Year: 1935.

Docket No. 98077.

On Saturday morning, June 3, 1939, a conference was held in my office on the above-entitled case which is now pending before the United States Board of Tax Appeals as Docket No. 98077.

There were present, in addition to myself, Mr. Harold N. Graves, Assistant to the Secretary; Mr. John P. Wenchel, Chief Counsel; Mr. A. R. Marrs, Head, Technical Staff; Mr. T. C. Mooney, Head, New York Division, Technical Staff; and Mr. Eldon O. Hanson, Counsel for the New York Division. Messrs. Mooney and Hanson were called to Washington for this purpose. Mr. Graves was invited to attend owing to his prospective assignment during my leave of absence which will shortly begin.

The facts and issues were rather fully discussed. Since you are familiar with them, they need not be repeated here. Under the plan of decentralization, as set forth in the memorandum creating the New York Division of the Technical Staff, which memorandum was issued by me and approved by the Secretary of the Treasury, this case must be handled on the merits by the New York Division unless the case, by the joint action of Mr. Wenchel and myself, is formally withdrawn from that procedure. Since this case involves a single issue of statutory application, even though it may raise mixed questions of law and fact, I think you will agree that no ground is present which would warrant a recommendation for the withdrawal of the case from the established procedure.

Coming to the merits of the controversy, and making due allowance for reasonable differences of opinion, which usually arise in connection with every tax avoidance scheme, it is my reasoned judgment that the Government has here a case which on principle it should win and which in practice it may very well win in the event litigation is necessary. I find no facts or circumstances which would distinguish it from many other cases in which we have decided to proceed with litigation.

Memorandum for Under Secretary Hanes  
In re: William V. Griffin.

In Commissioner v. George W. Griffiths, decided in the Government's favor by the Circuit Court of Appeals, Seventh Circuit, on February 25, 1939, the Court (reversing the Board of Tax Appeals) stated:

" \* \* \* Notwithstanding the argument by respondent, not disputed by the petitioner, that the sale of the stock to the corporation was free from fraud; that the transaction was in no way concealed and therefore not illegal, we are presented with a situation in which the taxpayer and his counsel intentionally formulated a contrivance for the sole purpose of enabling the taxpayer to avoid the payment of tax. \* \* \* "

The same extract was quoted approvingly and applied by the Board in its recent decision in Loewenberg v. Commissioner (May 16, 1939). I believe the above principle is applicable with equal force to the situation of Mr. William V. Griffin.

I have therefore concluded to allow the case to remain with the New York Division of the Technical Staff for handling under the usual procedure. Messrs. Graves and Wenchel concur with this conclusion. I have told Messrs. Mooney and Hanson that if a proposition of settlement were submitted in the approximate sum of \$64,000.00, plus statutory interest, the general basis of which I understand to have been previously explained to you by Mr. Mooney, I would not be opposed to such a closing of the case. Otherwise, the matter should be presented to the Board and, if need be, the courts for judicial ruling.

I have before me a suggested basis for amendatory legislation dealing with this general subject, which was prepared and submitted some weeks ago by Mr. Mooney but which, for reasons you may well appreciate, I have not previously been able to consider and pass on to you. This memorandum is now forwarded herewith.

(Signed) Guy T. Helvering  
Commissioner.

Attached:  
Mr. Mooney's memorandum.

## Motor Improvements, Incorporated.

1938

In January 1939 Mr. James Graham, president of the corporation, called on Mr. Hanes to discuss the method of reporting, for income tax purposes, profits realized in 1938 in settlement of litigation between his corporation and the A and C Spark Plug Company. Mr. Hanes asked Mr. Helvering and Mr. Reed, who were then in his office on other matters, to discuss the issue with Mr. Graham. Mr. Graham was orally advised that in the opinion of Mr. Helvering and Mr. Reed the total amount received in 1938 would have to be included in the gross income to be reported for that year and that there was no provision in the statute that would permit the prorating of the amount over the years covered by the infringement of patents.

Mr. Graham did not agree with such opinion and requested that a formal conference be arranged at a later date. At Mr. Hanes' request a memorandum dated February 3, 1939 was prepared advising him of the Bureau's position. A conference was held in the Bureau between Mr. Graham and Mr. Reed on February 14, 1939 at which time Mr. Graham was again advised that the statutes did not permit prorating the proceeds of the damage suit in the manner in which he persisted he should be permitted to do. On February 23, 1939 a letter was addressed to Mr. Graham in reply to his letter of February 18, 1939 in which he asked to be advised of the basis of the Bureau's ruling and the citation of any cases involving the issue which had been decided by the Courts. Similar information was transmitted to Senator Barbour in reply to his letter dated March 1, 1939 on behalf of Mr. Graham.

VERNON F. TAYLOR AND RUTH C. TAYLOR

Vernon F. Taylor and Ruth C. Taylor, San Antonio, Texas. Gift tax deficiencies for years 1935 and 1936. Pending before Board of Tax Appeals, Docket Nos. 96893 and 96894. Taxpayers represented by Mr. O. Max Gardner and Mr. George Rogers, of Washington, D. C. Question: Fair market value of donated stock of Peerless Oil & Gas Company, for gift tax purposes.

These cases were brought to my attention by Under Secretary Hanes, in oral conversation on at least two occasions. Relying upon statements from Mr. Vernon F. Taylor, or his counsel, Mr. Hanes was of the fixed impression that the cases had been definitely settled in Washington, D. C., whereas the Southwestern Division, Technical Staff, was seeking additional supporting data desired by Division Counsel before concurring in the basis of settlement recommended by the Head of that Division. The cases had not been settled in Washington prior to the formation of the Southwestern Division on April 1, 1939, and Division Counsel was entirely within his rights in calling for the additional information before passing upon the valuation dispute. Correspondence with the Southwestern Division was necessary to check certain unusual statements, which were contrary to established procedure, made by Mr. O. Max Gardner.

The cases were made the subject of a memorandum dated September 20, 1939 (copy attached) addressed by me to Mr. Hanes, which I discussed with him orally at a luncheon engagement. Mr. Hanes agreed with me that the additional information requested was reasonable and he stated that he would so advise the taxpayer, or his counsel.

(C O P Y)

September 20, 1939.

## MEMORANDUM FOR UNDER SECRETARY HANES:

In re: Vernon F. Taylor,  
Ruth C. Taylor,  
San Antonio, Texas.

Years: 1935 and 1936.

Dockets: #96893 and #96894.

The Taylor cases involve the question of the fair market value of stock of the Peerless Oil and Gas Company for gift tax purposes. The gifts were made in December, 1935, and September, 1936. This matter has been the subject of prior conversations between us.

The counsel for the taxpayers are objecting to the handling of these cases on two principal grounds:

(1) That Mr. William G. Cullen, now the Head of the Southwestern Division of the Technical Staff, "was specially designated and authorized to settle the case in March, 1939, prior to the creation of the Southwestern Division of the Technical Staff; and that a definite settlement agreement was reached between Mr. Cullen and representatives of the taxpayer"; and

(2) That certain additional information respecting the properties owned by the Peerless Company, requested by Counsel for the Staff Division represents an unreasonable and costly demand.

I am advised that Mr. Cullen never considered that he was specially designated and authorized to settle the cases, and made no statements that he thinks would be so construed.

Concerning the request for additional information, the facts are that Mr. Cullen submitted a recommendation for settlement in the cases to Division Counsel of the Southwestern Division on June 28, 1939, in accordance with the prescribed

Memorandum for Under Secretary Hanes.  
In re: Vernon F. and Ruth C. Taylor.

decentralization procedure in Board Docket cases. On July 1, 1939, Division Counsel addressed a memorandum to Mr. Cullen, a copy of which is attached. On July 8, pursuant to the request contained in Division Counsel's letter, Mr. Cullen addressed a letter to Mr. George Rogers requesting information sufficient in detail to permit a determination of the values of the several producing and nonproducing royalties and leases owned by the Peerless Oil and Gas Company in the States of Texas and Oklahoma at the dates involved in these appeals. On July 12, Mr. Rogers addressed a letter to Mr. Cullen protesting against the requirement to furnish information as requested, and requested that the case be considered without the submission of such evidence. On July 18, Mr. Cullen addressed a letter to Mr. George Rogers in which he states: "The request made in letter dated July 8, 1939, did not contemplate an elaborate and expensive valuation report, but it is believed necessary that a report showing a detailed list of the producing and nonproducing royalties located in Texas be made in order to enable this office through the aid of the facilities of the Agent in Charge to make a determination of the values which should be assigned to the properties of the corporation. It is therefore requested that the data to be furnished contain the name of each lease or royalty, its legal description by sections, surveys, number of acres, etc., the percent of interest owned and the date of purchase, cost, and, if producing, the production (corporation's interest in barrels) for the years 1935 and 1936. The information now in the file relative to properties located in Oklahoma is believed sufficient."

It does not seem to me that this request for additional information is unreasonable, or that it would be either difficult or costly to fulfill. The Staff Division does not request detailed valuations as to each separate item of property, but merely a list of the properties, with certain descriptive information as above indicated, for check and verification by the Bureau engineers.

(Signed) Guy T. Helvering

Commissioner.

ARM/ld

HOUSTON PRINTING CORPORATION

Houston Printing Corporation, Houston, Texas. Income and profits tax deficiencies aggregating \$75,000.00 for years 1936 and 1937. Statutory notice mailed November 14, 1939, pursuant to direction of Head, Southwestern Division, Technical Staff, dated October 26, 1939. Question: Credit for surtax purposes on undistributed profits.

An interview was held in the office of Under Secretary Hanes, there being present Mr. W. P. Hobby, President of the taxpayer corporation; Mr. Jesse H. Jones; Commissioner Helvering; and Under Secretary Hanes. None had been present at the conference held in the Corporation's tax case by the Houston office of the Southwestern Division. On the basis of Mr. Hobby's ex parte presentation, and a letter by him to me dated November 10, 1939 (copy attached), Mr. Hanes addressed the following memorandum to me under date of November 14, 1939:

"I attach hereto letter which I have received from Mr. W. P. Hobby. When Mr. Hobby was here he laid this case before you and me in my office. I have read his letter to you dated November 10, 1939, and it seems so apparent that his case ought to be settled without further expense on his part that I cannot understand the continued horse-trading going on in the Decentralized Unit. Apparently, they are saying to Hobby 'accept our assessment for 1937 and we will not levy one against you for 1936.' It seems to me that he either owes tax for 1936, or he doesn't owe it for 1937. I am discouraged about the way this case has been handled."

The representations of Mr. Hobby were denied by the Staff employees involved, in the Southwestern Division. See my memorandum to Mr. Hanes dated December 15, 1939, suggesting a course of action set forth in the attached copy of letter mailed January 17, 1940, by the Head, Technical Staff, to the Head, Southwestern Division. My recommendation not to transfer the file of the case to Washington for review was approved by the Secretary's memorandum dated January 15, 1940.

Houston Printing Corporation, continued.

This case, together with that of Vernon F. Taylor and wife, forms the basis of an unfavorable opinion held by Mr. Hanes respecting the Southwestern Division. In neither instance was the Staff given opportunity to state its side of the case before the unfavorable judgment was formed.

## THE HOUSTON POST

Office of  
W. P. Hobby,  
President

Houston, Texas

November 10, 1939.

Hon. Guy T. Helvering,  
Commissioner of Internal Revenue,  
Washington, D. C.

Sir:

While in Washington sometime ago, I discussed with you the matter of proposed additional assessment of income tax against this Corporation for the years 1936 and 1937. I came to see you as President of the Houston Printing Corporation and I hope you will recall having referred me to two members of your legal staff. After a brief discussion with me they were of the opinion that this matter should be permitted to take its course through the usual channels and, as I understood the situation, if we did not obtain relief the way would be open for us to return to your office.

Following this discussion a protest was filed with the Internal Revenue Agent in Charge, Dallas Division, and conferences held with the conferees in the office of the Internal Revenue Agent there and later with the Houston Division of the Technical Staff all to no avail. I, therefore now request that your office ask that the file in this case be transferred to Washington for review.

In order that your memory be refreshed with respect to this matter, may I furnish you briefly the facts involved.

On or about May 1, 1931, Houston Printing Company borrowed \$600,000.00 under a mortgage indenture which permitted the Company to pay dividends only if the effect of payment of dividends did not result in diminishing working capital, increasing liabilities, decreasing net worth, etc. The indentedness secured by the mortgage indenture matured serially in amounts ranging from \$50,000.00 to \$100,000.00 annually through May 1, 1935, and \$275,000.00 on May 1, 1936. The maturities on the indentedness were made through May 1, 1935, though it was apparent that the maturity of \$275,000.00 on May 1, 1936, could not be met. As a consequence, the Company arranged with the National Bank of Commerce, Houston, Texas, for a loan to provide whatever supplemental funds might be necessary to meet the sinking fund requirement. The loan agreement with the National Bank of Commerce provided, among other things that the bonds which were to be taken up by the funds advanced under the loan agreement were to remain alive and constitute security to the bank for the funds it advanced in a manner which would subrogate the bank to all of the rights and remedies of the bondholders.

## THE HOUSTON POST

Office of  
W. P. Hobby,  
President

Houston, Texas

#2-Hon Gay T. Helvering.

In connection with this loan from the bank, the Company agreed with the National Bank of Commerce that it would pay no dividends while any of the funds advanced by the bank remained unpaid. Under this loan agreement the bank advanced from June 1, 1935 through May 1, 1936, in amounts of \$15,000.00 to \$18,000.00 per month, an aggregate of \$189,000.00. On May 6, 1936, the twelve notes ranging from \$15,000.00 to \$18,100.00 were consolidated into one note for \$189,000.00. This new note matured on demand, though it was understood between the bank and this Company that it was to be paid at the rate of \$8,000.00 per month beginning June 1, 1936, and it was so paid. The loan agreement with the bank was dated as of June 1, 1935, though it was not executed by the bank until July 1, 1935. When the bank went to execute this instrument, the officials of the bank noted that the prohibition against payment of dividends was not sufficiently or to their entire satisfaction included in the instrument. Before the bank would execute this instrument they required that I as President of the Houston Printing Company write the bank a letter evidencing the fact that no dividends would be paid by the Company until the amounts owed to the bank under this loan agreement were fully repaid. Accordingly I called at the office of the bank and signed the required letter written July 1, 1935, on the stationery of the National Bank of Commerce.

During the years 1936 and 1937 the Houston Printing Company claimed a credit for dividends paid because of a restriction against the payment of any dividends equivalent to the undistributed profits of the Corporation. The examining agent contends that there was not an effective restriction against the payment of dividends within the purview of the Revenue Acts.

The representative of the Technical Staff with whom this matter was discussed agreed that the provisions of the bond indenture were effective with regard to the loan from the National Bank of Commerce as well as to the bond indebtedness. He further agreed that under the restrictive clauses of the bond indenture dividends could not be paid during the year 1936, and agreed to allow our contentions with respect to that year. Under the restrictive clauses of the bond indenture some amount of dividends probably could have been paid during the year 1937. He, therefore would give no relief for the year 1937. The relief he offered for the year 1936, however, was dependent upon our closing the case upon the basis of his allowing our contention for the year 1936, and our agreeing to the assessment for the year 1937. Since we were prohibited under our agreement with the bank from paying any dividends for either the year 1936 or year 1937, we could not close on the basis offered by the representative of the Technical Staff.

## THE HOUSTON POST

Office of  
W. P. Hobby,  
President

Houston, Texas

#3 Hon Guy T. Helvering.

We have submitted affidavits from the officers of the bank definitely showing that the loan agreement was made with the understanding that no dividends could be paid so long as any of the funds borrowed from the bank remained unpaid. We have further shown that the letter given to the bank by our Company constituted a part of the loan agreement and was as effective as if it had been a clause contained in the agreement. We are therefore unable to understand why we are being refused the relief for which we ask.

All of these transaction with respect to the bonds and the loan made by the National Bank of Commerce were made prior to the enactment of the 1936 Act. It therefore is obvious that none of these transactions or instruments were made with a view of limiting or avoiding income taxes. Under the circumstances we do not feel that we should be forced to incur the expenditure necessary further to litigate this matter and upon a review of this case we believe your office will agree with us.

Respectfully yours,

Houston Printing Corporation,

By: (Signed) W. P. Hobby  
President

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December 15, 1939.

## MEMORANDUM FOR UNDER SECRETARY HANES:

I have your memorandum of November 14, 1939, transmitting a letter to you from Mr. W. P. Hobby dated November 13, 1939. This correspondence relates to the income and profits tax controversy of the Houston Printing Company, Houston, Texas, for the years 1936 and 1937. Mr. Hobby addressed a letter to me under date of November 10, 1939 dealing with the same subject. Undoubtedly, if the things mentioned in your memorandum are taking place in the Houston office of the Southwestern Division of the Technical Staff, it is a reprehensible situation which needs immediate correction.

I have three reports from the Staff Division in connection with this case. In these reports it is stated that Mr. Hobby was not present at any conference with the Technical Staff and that no one in the Staff office at Houston has ever seen or spoken to him to their knowledge as late as their report dated November 17, 1939. I mention this circumstance to show that Mr. Hobby has had to rely upon the reports of his representative or associates. In the same way, I have to rely upon the reports of the Bureau employees.

The Staff reports deny that the conferee "agreed to allow our (the company's) contentions with respect to that year (1936)." They deny that the conferee agreed that under the restrictive clause of the bond indenture of May 1, 1931 "dividends could not be paid during the year 1936." They deny that the taxpayer has "shown that the letter given to the bank by our company constituted a part of the loan agreement and was as effective as if it had been a clause contained in the agreement;" on the contrary, it has been consistently maintained by the Field employees of both the Agent in Charge and the Staff Division that the letter of July 1, 1936 was, under the corporation statutes of Texas, an unauthorized act not binding upon the corporation.

These reports specifically deny that the taxpayer was recognized as being entitled, under the law, to relief for the year 1936, and that such relief was withheld because the taxpayer refused to accept the Government's case for the year 1937. The supporting statement prepared by the Houston office of the Technical Staff and adopted by the Head of the Southwestern Division on October 26, 1939, contains the following paragraph:

-2-

Memorandum for Under Secretary Hanes.

"There may be some ground for arguing that the taxpayer was prohibited from paying dividends during the year 1936 by the fact its ratio of current assets to current liabilities for that year was approximately 1.80 to 1 and that by its indenture of May 1, 1931, it was prevented from paying dividends in the event such payment would decrease the ratio of current assets to current liabilities below 3.50 to 1. However, the taxpayer makes no contention for relief from that source, preferring to rely entirely upon the letter of July 1, 1935, and the affidavit of Messrs. Simpson and Doherty."

From this it appears that even the confidential memorandum in the case makes no such admission of error as regards the year 1936. The above-quoted statement respecting the ratio of current assets to current liabilities represented an accounting theory of the conferee by which he was seeking to work out a basis of settlement with the taxpayer. The Staff conferees do conscientiously endeavor to close cases. Upon closer analysis there arose the gravest doubt as to the accuracy of the conferee's theory, but since no settlement had resulted it was considered unnecessary to change the remark in the supporting statement.

According to the Staff report of November 17, 1939, the following is what transpired at and shortly after the conference in the case:

"Mr. B. H. Wilson handled the case in this office for the Staff, and the taxpayer was represented by Mr. H. I. Wilhelm of the J. A. Phillips Company. Mr. W. P. Hobby, the President of the corporation, did not appear in the conference, nor has anyone in this office ever seen or spoken to him to their knowledge. After having reviewed the facts in the case, and listened to the arguments put forth by Mr. Wilhelm, Mr. Wilson states that he, at the conclusion of the conference, advised Mr. Wilhelm that if the taxpayer would submit a proposal of settlement on the basis that the Staff allow the claim for dividend credit for 1936 and waive the claim for any credit in 1937 he would seriously consider recommending such a proposal. He states, however, that he then and there told Mr. Wilhelm that he was still undecided relative to the year 1936 but felt the Government's position was much stronger for 1937. For such reason he was willing to seriously consider a proposal for settlement for 1936 and 1937 on the basis of the allowance of the credit for 1936 and the full deficiency for 1937. Mr. Wilhelm knows that any recommendation made by any of the conferees in the Staff is subject to review.

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Memorandum for Under Secretary Hanes.

"Mr. Wilson was of the opinion at the conclusion of the conference that Mr. Wilhelm was in favor of submitting such a proposal, but Mr. Wilhelm stated that before submitting such a proposal he wished to take the matter up with the attorneys for the company. A few days later when Mr. Wilson was discussing another case with Mr. Wilhelm on the telephone, Mr. Wilhelm advised him that after discussing the case with the taxpayer's attorneys, they had decided that the letter dated July 1, 1935, constituted a sufficient restriction relative to the payment of dividends to entitle the taxpayer to the credit claimed in both years and would therefore consider no basis of settlement other than the full surrender by the Staff of the surtax asserted for both years, amounting to \$39,040.19 for 1936, and \$35,987.77 for 1937. He therefore suggested to Mr. Wilson that the statutory notice be issued.

"Mr. Wilson is definite in his recollection that he did not state to Mr. Wilhelm that he admitted that the taxpayer was entitled to the relief sought for 1936, or that he would not settle 1936 unless the taxpayer signed up for 1937."

The taxpayer's representative has apparently never contended, or submitted any evidence to prove that there was a ratification by the Board of Directors of the subject matter of the letter of July 1, 1935, copy attached.

Under the circumstances I have caused instructions to be issued to the Head of the Southwestern Division of the Technical Staff to call another conference in the case with a view of developing certain matters which are set forth in the attached proposed letter. I do not believe that the circumstances justify me in taking the case out of the regular decentralized procedure or causing the file to be transferred to Washington for review.

(Signed) Guy T. Helvering  
Commissioner.

Enclosures:  
Copy of letter dated 7/1/1935  
Proposed letter.

G-TS:ARM

January 17, 1940.

Mr. W. G. Cullen, Head,  
Southwestern Division, Technical Staff,  
1426 Kirby Building,  
Dallas, Texas.

In re: Houston Printing Corporation,  
Houston, Texas.

Years: 1936 and 1937.

My dear Mr. Cullen:

The above-entitled case was pending before the Houston office of the Southwestern Division of the Technical Staff in the pre-90-day status and after conference with the taxpayer's representative, there was issued by your office on October 26, 1939, a memorandum directing the issuance of a deficiency notice on a basis in substantial agreement with the findings of the Internal Revenue Agent in Charge, Dallas, Texas. The deficiency notice was accordingly issued on November 14, 1939.

It is requested that you arrange a further conference in this case with the following objects in mind:

1. Endeavor, if at all possible, to have present at any conference, or conferences, Mr. W. P. Hobby, President of the Houston Printing Company.

2. Discuss specifically with the taxpayer or its representative, the effect of the refinancing arrangement made with the bank on or about May 6, 1936, as constituting a new contract executed subsequent to April 30, 1936.

3. Determine, if possible, the reasons for failure by the Board of Directors in its resolution of May 4, 1936, to mention the letter of July 1, 1935 addressed to the National Bank of Commerce and signed by Houston Printing Company, by W. P. Hobby, President.

4. Endeavor, if possible, to determine from the individual directors, themselves, their knowledge and conduct respecting said

- 2 -

Mr. W. G. Cullen,  
In re: Houston Printing Corporation.

letter of July 1, 1935, above mentioned. In other words, the facts should be fully developed respecting the position of this taxpayer to claim ratification by its directors of the content of said letter dated July 1, 1935, either by the affirmative conduct of the acquiescence of the directors.

If it can be so arranged I would appreciate the holding of this conference in Houston, Texas, by yourself, with Division Counsel Backstrom, and Messrs. Jones and Wilson present.

I note that all the Staff papers refer to this case by the name of "Houston Printing Corporation." The trust indenture of May 1, 1931, the agreement of June 1, 1935, and the letter of July 1, 1935 are in the name of "Houston Printing Company." Please note the difference between the words "Corporation" and "Company" in the taxpayer's name. The release by the National Bank of Commerce of Houston under date of April 20, 1938, it being Exhibit E attached to your letter of November 20, 1939, states that the Houston Printing Corporation, has succeeded to the properties, rights and interests of the Houston Printing Company. Please be careful to check this difference in the corporate name. It is essential to distinguish between a mere change of name on the one hand, and the formation of an entirely new corporation on the other hand. If there has been formed an entirely new corporation, we may have transferee proceedings involved, and our prior reference to the taxpayer may have been erroneous as to its exact name.

Sincerely yours,

(Signed) A. R. Marr  
Head, Technical Staff.

ARM/ld

In re: The Cudahy Packing Company and  
Subsidiary Companies,  
Chicago, Illinois.

At the request of Mr. Hanes, former Under Secretary, a conference was held in his office on April 13, 1939, from 9:00 A. M. to 5:00 P. M., at which the Commissioner was present, as was Mr. Hanes' assistant, Mr. Young, and the taxpayers' and Bureau representatives.

The companies paid processing and floor stocks taxes aggregating \$11,910,935.71, and had processing taxes imposed and not paid of \$4,228,154.00. They had filed voluminous briefs and arguments and were contending for large net refunds.

Subsequent to that conference, at the request of Mr. Hanes, the taxpayers' representatives were furnished with what was then believed the most reasonable settlement figure - approximately \$400,000.00 - to be paid to the Government. This they refused to consider and to date have made no indication that they are willing to pay any deficiency. The Bureau representatives believe that a substantial deficiency should be secured in final settlement of the cases. Since then, Mr. Hanes had inquired from time to time as to the status of the case.

The taxpayers refused to sign waivers extending the statute of limitations on the Title III case and, accordingly, in order to insure collection of any deficiency, if it was subsequently found to be due, it was necessary to issue a statutory notice on December 5, 1939, in the amount of \$2,507,618.02. Additional field investigation was necessary for the preparation of the statutory notice. It was also necessary to make further investigation of the processing tax claim with a view to the issuance of statutory notice concurrent with additional investigation of the floor stocks tax claim in order to prepare the Government's defense to their suit in the United States District Court at Chicago for recovery of the floor stocks tax.

In re: Chatham Manufacturing Company,  
Winston-Salem, North Carolina.

Mr. Hanes, while Under Secretary, called the Commissioner on several occasions with respect to the progress of the investigation and settlement discussions of the processing tax refund claims and unjust enrichment liabilities of this case.

The company claimed approximately \$178,674.00 in processing and floor stocks taxes and had some liability for unjust enrichment taxes on account of the injunction which restrained the collection of processing taxes during the latter part of 1936. The case was a complicated one and required intensive and detailed investigation because of the fact that they manufactured many grades of blankets, ranging from a small percentage of cotton mixed with a large percentage of wool, to blankets consisting entirely of cotton.

After numerous conferences in the Bureau, a tentative agreement has been reached to enter into a final closing of both Titles by the payment to the taxpayer of \$8,500.00 as a net refund.

In re: Charles D. Barney and Company,  
14 Wall Street,  
New York, New York.  
Year: 1938.

Mr. John W. Castles, a member of the above-described partnership, called on Mr. Hanes, Under Secretary of the Treasury, on December 29, 1939, in connection with the firm's return of income then under consideration in the office of the Internal Revenue Agent in Charge of the Second New York Division and the case was discussed with Mr. Sullivan, then Acting Commissioner.

A brief was also left by Mr. Castles with Mr. Sullivan, setting forth in detail the issue involved, viz., proper treatment of a loss reported on the partnership's return of income for the year 1938 as having been incurred as the consequence of the sale of a seat on the New York Stock Exchange, the firm's contention with respect to the allowable deduction and the allowance which the field representatives agreed to recommend for the purpose of settling the case.

After carefully considering the problem involved the Bureau concurred in the revenue agent's views and so advised Mr. Castles.

Mr. Castles was further advised that in the event he did not agree with the recommendation of the Internal Revenue Agent in Charge, he would be given an opportunity to present his contentions to the New York Division of the Technical Staff for consideration.

In re: Illuminating Shares Company,  
New Haven, Conn.

On November 3, 1938 and at least two subsequent dates conferences were held in Mr. Hanes' office relative to the proposed integration of Illuminating Shares Company, a public utility holding company, pursuant to proposed orders to be issued by Securities and Exchange Commission. Conferences were attended by representatives of Securities and Exchange Commission, Chief Counsel's office, various Audit Review Divisions and Engineering and Valuation Division. The taxpayers were assured at first conference by Mr. Hanes that prompt consideration would be afforded their request for rulings with respect to any simplification plan. Such request was filed December 12, 1938 and it developed that the corporation had never filed any tax returns, although organized in 1931, and there was a possible deficiency of about \$200,000.00 for 1936, 1937 and 1938. The later conferences in Mr. Hanes' office discussed the merits of the deficiency which turned on whether the taxpayer was the beneficial owner of stock of an operating company, the taxpayer denying such ownership. When Mr. Hanes found the taxpayer had represented it was the owner in previous proceedings involving capital stock tax, he took no further action of any kind, and the taxpayer proceeded in the usual way, through the Internal Revenue Agent's office and the Technical Staff to dispose of the deficiency. After the question of the additional tax had been disposed of, a ruling was issued by the Commissioner on December 21, 1939 to the effect that the proposed simplification in obedience to a specified form of an order of the Securities and Exchange Commission would be tax free.

In re: Commonwealth and Southern  
Railroad Corporation and  
Tennessee Electric Power Company,  
New York, New York.

On February 3, 1939 a conference was held in Mr. Hanes' office in regard to the basis of assets of Commonwealth and Southern Corporation and Tennessee Electric Power Company which the corporations proposed to sell to the Tennessee Valley Authority. Merits of case not discussed, - Mr. Hanes assuring taxpayers' representatives (Mr. Roswell Magill and officials) that prompt consideration would be given request for ruling and closing agreement. Application filed February 4, 1939, Commissioner's ruling issued March 16, 1939 and closing agreements entered into thereafter.

In re: Comet Company,  
St. Paul, Minnesota.

On or about December 15, 1938 a conference was held in Mr. Hanes' office from 4:30 P. M. to 7:30 P. M., relative to the proposed reorganization of Comet Company, a personal holding company, with Premier-Pabst Corporation in which Comet held a substantial interest. Field investigation disclosed the reorganization was one whereby the stockholders of Comet were attempting to exchange their holdings for stock of Premier-Pabst in a tax free exchange, after Premier-Pabst was recapitalized, rather than liquidate their corporation under the provisions of Section 115(c) of the Revenue Act of 1938. Numerous conferences were held in Bureau with the taxpayers' attorneys (Messrs. Korner, Doyle and Blair), with the result that a ruling was issued December 12, 1938 on their application of November 19, 1938 approving a recapitalization of Premier-Pabst, and, at the specific request of the taxpayers' attorneys, no opinion of the attempted reorganization of Comet was expressed, the attorneys being fully aware of the Bureau's unfavorable attitude toward a nontaxable reorganization. The attorneys were advised by Mr. Hanes that he was convinced the Comet reorganization would be taxable and the Bureau's method of computing such tax was fair.

In re: General Motors Securities Corporation and  
General Motors Management Corporation,  
1776 Broadway,  
New York, New York.

On or about September 15, 1938 a conference was held in Mr. Hanes' office relative to the proposed reorganization of General Motors Securities Corporation and General Motors Management Corporation. Matter discussed involved legal question which Mr. Hanes referred to Mr. Wenchell. As result of conference amended request for ruling was filed September 28, 1938 and ruling desired by taxpayer issued December 16, 1938. Closing agreements entered into later.

In re: Fisk Rubber Company,  
Boston, Massachusetts.

Years: 1933 et sub.

On or about June 5, 1939 a conference was held in Mr. Hanes' office in regard to the 1933 and subsequent years returns of Fisk Rubber Company which were in Securities Section, Engineering and Valuation Division, awaiting formation of office policy in regard to basis of assets acquired in a bondholders reorganization. President of Company indicated he would be willing to waive transferor's basis of assets if Bureau would allow the corporation a reasonable value of assets at date acquired. Mr. Hanes referred the President of the company to the Unit, the returns were referred to the Internal Revenue Agent in Boston, and closed in that office.

GROUP II

In re: Times Herald Printing Company,  
Dallas, Texas.

Mr. T. C. Gooch, vice president of the corporation, called on Mr. Hanes, then Under Secretary of the Treasury, on August 23, 1939, relative to the income tax case of the corporation for 1938.

Mr. Gooch stated that the case was under investigation in the office of the Internal Revenue Agent in Charge, Dallas, Texas, and that the revenue agent who was examining the records had suggested the possibility that section 102 of the Revenue Act of 1938 relating to the surtax on corporations improperly accumulating surplus was applicable to the case. Mr. Gooch requested that if possible the case be brought to Washington for determination of the liability in order that competing organizations in Texas would not be in a position to ascertain that the Bureau was proposing to impose the tax under section 102.

Mr. Hanes referred Mr. Gooch to the Income Tax Unit of the Bureau and he discussed the case with Mr. T. C. Mooney, Deputy Commissioner, Income Tax Unit. Mr. Gooch was advised that there was no apparent reason for making an exception in this case to the decentralization procedure which had been established but he was assured that the treatment of the case in the field would not result in any publicity.

The report of the revenue agent's examination covering the year 1938 was received recently in the Bureau and it is recommended therein that a deficiency of \$12,609.38 be assessed, of which \$12,574.44 represents the tax liability as computed under section 102 of the 1938 Act.

In re: David M. Look,  
New York, New York.

Under date of June 20, 1939, a memorandum was received from Under Secretary Hanes' office, signed by P. Young, relative to an assessment of income tax against the above-mentioned taxpayer in the amount of \$121,336.11, for the year 1929, which was being paid in installments in accordance with an agreement with the Collector, Third New York District.

Mr. Young advised that Mr. Look called at his office and stated that he did not have the funds with which to make the agreed installment payments and he desired to know whether a more satisfactory basis for payment could be evolved; whether the total unpaid balance could be reduced; and whether a reduction could be made in the interest accruing on the unpaid balance.

In a memorandum to Under Secretary Hanes dated June 20, 1939, he was advised that the deficiency in question was assessed in accordance with the decision of the United States Board of Tax Appeals and there appeared to be no basis for a reduction of the balance due or the interest accrued thereon; that there was no authority in law for the acceptance of an offer in compromise for tax legally due if it can be collected; and that the period during which the Commissioner may extend the time for payment of deficiencies under section 372(j) of the Revenue Act of 1928, as amended by section 816 of the Revenue Act of 1938, had long since expired.

The Under Secretary was advised that the matter of collection of the deficiency in this case was a matter entirely within the discretion of the collector.

In a memorandum dated June 28, 1939, the Under Secretary suggested that the matter be referred to the collector with a view of working out a more satisfactory basis of payment of the outstanding deficiency.

On July 6, 1939, Mr. Hanes' suggestion was transmitted to the Collector, Third New York District, and Mr. Hanes was so advised.

Under date of September 12, 1939, the collector advised this office that Mr. Look had visited his office and had conferred with Chief Field Deputy Alexander and in his opinion the facts in Mr. Look's case did not warrant or justify any action to enforce collection at this time.

In re: A. G. Budge,  
Honolulu, Hawaii.

Mr. Budge called upon Mr. Hanes on April 23, 1939, concerning his case which was then pending before the Internal Revenue Agent in Charge at Honolulu, Hawaii, as result of which Mr. Hanes requested Mr. Wenchel to accord Mr. Budge a hearing in the Pacific Division of the Technical Staff. Subsequent to that time the taxpayer's attorneys have advised Mr. Hanes of the progress that they have been making on the case and on December 29, 1939, Mr. Hanes addressed a memorandum to Mr. D. W. Bell, in which he stated that he had been following this tax case and had told the taxpayer's counsel that he would turn this matter over to Mr. Bell and that Mr. Bell would be good enough to follow it with the Bureau and see that justice was done to all concerned.

CALAMBA SUGAR ESTATE

Calamba Sugar Estate, 2 Pine Street, San Francisco, California. Income and profits taxes for years 1915 to 1934, inclusive. Pending in pre-90-day status. Taxpayer represented by Mr. W. W. Spalding, Washington, D. C. and Mr. C. F. Jacobson, apparently a Washington representative of sugar interests.

Relying upon the representations of Mr. C. F. Jacobson, in an oral interview, Mr. Hanes suggested in his memorandum of November 12, 1938 (copy attached), that the case be handled in the Baltimore District, "as it seems to me there is a good deal of substance to his (Jacobson) argument that the many years spent on this case here might be lost to the Government if it is sent to San Francisco. I will be guided by your opinion in the matter." No Bureau man was present at the interview between Mr. Jacobson and Mr. Hanes, but it is evident that the representations of the former did not present the entire situation. See my memorandum to Mr. Hanes, dated November 17, 1938 (copy attached), wherein I conclude as follows:

"It is my considered judgment that a compliance with this taxpayer's request would shortly become widely known among Washington tax practitioners and would form a basis for drawing innumerable cases back into the Bureau in Washington and thereby destroy our major objective in the program we are undertaking to inaugurate and perfect."

I heard nothing more of this matter from Mr. Hanes.

COMMISSIONER  
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November 12, 1938

To: Commissioner Helvering  
From: Mr. Hanes

A Mr. C. F. Jacobson called upon me during your absence and earnestly requested that we consider the long history of discussions, etc., in the matter of the Calamba Sugar Estate, Manila, Philippine Islands, 1915-1934, in reaching a decision as to whether or not the case should be finally settled in the Baltimore district where there are men thoroughly familiar with the history, or whether it should be transferred to the San Francisco office. I would like to have your opinion on this matter as it seems to me there is a good deal of substance to his argument that the many years spent on this case here might be lost to the Government if it is sent to San Francisco. I will be guided by your opinion in the matter.

J. W. H.

C-TS:ARM

November 17, 1938.

MEMORANDUM FOR MR. HANES:

Re: Calamba Sugar Estate,  
2 Pine Street,  
San Francisco, California.

Taxable Years: 1915 to 1934, inclusive.

I have your memorandum dated November 12, 1938, relative to the request of the representative of the Calamba Sugar Estate that its case be withdrawn from the decentralization procedure and finally settled in the Baltimore District where supposedly there are men thoroughly familiar with its history. According to our records the Calamba Sugar Estate is a domestic association; the taxpayer claims it is a Philippine association. This is an important issue in the case. The Calamba Sugar Estate was created by a group of San Francisco promoters under a declaration of trust executed at San Francisco on January 16, 1914, by Alfred Ehrman, M. Fleishacker and Oscar Sutro, all of San Francisco, who were designated as trustees. The business activities of the Estate, aside from financial management and control, are all conducted within the Philippine Islands. The records pertaining to the organization of the trust estate, the issuance of its securities and its general financial records are kept in San Francisco because the financial operations of the taxpayer are controlled by interested parties in San Francisco through their manager resident in the Islands. The records of the mill operations are kept in the Islands.

All returns have been filed in San Francisco. One return was timely filed in 1916, but all the rest were delinquent returns.

The original examining agent's report dated February 12, 1936, was prepared by Agent Bercaw in San Francisco; a supplemental report, dated June 30, 1937, was prepared in the Philippine Islands under Agent Bercaw's supervision and sent to the Agent in Charge at San Francisco who then transmitted same untyped to Washington. The taxpayer has received copies of both the original and supplemental reports but has not yet filed a detailed protest thereto, preferring to await the issuance of a preliminary letter and then protest the case as a whole. Thus far the taxpayer has filed a brief statement respecting the single issue that it is a Philippine association and not a domestic association.

The case in Washington was handled exclusively by Auditor Guy V. Hunkle who advises that he did not receive the supplemental report until early Autumn 1937. He further states that there has been no discussion on the merits of the tax liability. No preliminary letter had been mailed while the case was in Washington because Auditor Hunkle had been unable to do so under pressure of business; and besides an important issue on the merits would be determined by the decision of the Ninth Circuit in the case of Hawaiian Philippine Company of Honolulu, Hawaii, for the year 1930, docket number 69619, which case is now pending before that circuit. Therefore, the discussions to date have related to purely procedural matters and virtually no discussion has occurred respecting the merits of the tax liability. In any event, Auditor Hunkle who prepared a preliminary letter for mailing and transmitted same with the administrative file to the Agent in Charge at San Francisco, is always available for detail to San Francisco. It appears further that when a serious protest is made to the preliminary letter, the case will become the subject of conferences and further development on the facts. A substantial portion of the evidence is available in San Francisco where it is believed a duplicate set of the material Philippine records is kept. From the standpoint of handling, I have no doubt that San Francisco is the most convenient place, next to the Philippine Islands.

Auditor Hunkle further advises that there has never been the slightest intimation that the taxpayers were in a settlement frame of mind. On the contrary, that their conduct to date, while entirely proper, evidences a vigorous contest of the issues without regard to an attitude of moderation or give and take.

In so far as the issue of special assessment is concerned (that is, determination of liability by reference to comparable concerns under Section 210, Revenue Act of 1917, and Sections 327 and 328, Revenue Acts of 1918 and 1921), it is a fact that the matter must be referred to the Unit in Washington for assembly of the data of comparable concerns, and possibly the actual preparation of the data sheet. This possibility has long been recognized as an administrative feature in the plan of decentralization. There are other respects in which advice must be secured from Washington under the plan of decentralization, namely, on engineering, valuation and scientific problems, as well as broad legal questions of policy having a bearing upon numerous taxpayers widely dispersed throughout the country. This is no defect in the decentralization program nor does it afford any justification for withdrawing a case in its entirety from the decentralized procedure. If the existence of special assessment in this case may be said to justify the return thereof to Washington, then, by analogy with other comparable reasons of no greater force, a large proportion of all cases would be handled in Washington. This

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Memorandum for Mr. Hanes.

would unquestionably defeat the whole decentralization movement. I assure you there is no substantial merit to that feature of the taxpayer's request although as a matter of initial impression it is plausible.

The next reason assigned by the taxpayer is that a hardship would be imposed upon it since it has employed Washington counsel to represent it in the pending cases and such counsel has been engaged thereon for some two or three years. If counsel has done much work on these cases, the Bureau has not been the beneficiary thereof. As above stated, no protest has as yet been filed. The Bureau does not object to taxpayers retaining Washington counsel but it seems impossible, if we are to carry this program through, to give any weight whatsoever to the plea that the presence of Washington counsel in a case should change the standard procedure. It is recognized that in many cases considerable though inconclusive work will have been done on cases which of necessity must be transferred to the field and covered under the field procedure. This is inevitable in a period of transition. After the pending cases are disposed of, that question will not again arise. Therefore, even if considerable work had been done in the matter of the Calamba Sugar Estate, I would still recommend that the case be left in the San Francisco office.

It is my considered judgment that a compliance with this taxpayer's request would shortly become widely known among Washington tax practitioners and would form a basis for drawing innumerable cases back into the Bureau in Washington and thereby destroy our major objective in the program we are undertaking to inaugurate and perfect.

Commissioner.

AHM/vss

THE CITY NATIONAL BANK AND TRUST COMPANY  
OF COLUMBUS

The City National Bank and Trust Company of Columbus, 20 East Broad Street, Columbus, Ohio. Income tax deficiencies for 1936 and 1937. Question: Bad debt deductions. Pending before Board as Docket No. 101,036.

Case considered by Cincinnati office, Central Division, Technical Staff, in pre-90-day status. On September 23, 1939, the Head of Central Division directed the issuance of a statutory notice.

On November 8, 1939, Mr. Hanes addressed a memorandum (copy attached) to me, stating that the taxpayer's president, Mr. J. H. McCoy, was referred to him by the Comptroller of the Currency; and requesting a report on the case "so that we can make arrangements to discuss it here with the Comptroller."

On November 20, 1939, a conference was held in Mr. Hanes' office between Government men only. I delivered to Mr. Hanes a lengthy report dated November 20, 1939, to me from the Head, Technical Staff. Mr. Hanes seemed to be in general agreement with our position, and stated he would turn the report over to the Comptroller's office for comment. This was done on December 26, 1939 and on December 27, 1939 Mr. Upham advised that the Comptroller's office was not disposed to disagree with the Bureau's action.

COPY

November 8, 1939

To: Commissioner Helvering

From: Mr. Hanes

Mr. J. H. McCoy, President of the City National Bank and Trust Company, Columbus, Ohio, who was referred to me by the Comptroller of the Currency, has a tax case now pending in the decentralized office in Cincinnati which is being handled by Mr. C. C. Guy of the Technical Division. Would you be good enough to ask for a report on this case, and advise me when you receive it so that we can make arrangements to discuss it here with the Comptroller. I will appreciate your having this matter expedited.

J.W.H.

FREDERICK BELLER

Frederick Beller, San Diego, California. Income tax liability, year 1928. Stipulated before Board of Tax Appeals and final order entered June 29, 1934. Memorandum transmitted from Under Secretary on October 20, 1939, in connection with taxpayer's rejected offer in compromise of \$3325.51, and requesting a conference be granted Mr. Beller. Conferences held October 24, 1939 and subsequently. Offer increased to \$8175.00, recommended for acceptance and approved by Acting Secretary, December 27, 1939. Mr. Beller's increased offer resulted from his submitting the additional evidence which the Staff had insisted upon all along.

In re: Barnes Newberry  
and  
Elizabeth Newberry  
Providence, Rhode Island.  
Years: 1928 to 1936 inclusive.

Shortly prior to September 14, 1939, Mr. Rademacher of Mr. Hanes' office telephoned and requested a memorandum concerning information and the present status of these cases. A six page memorandum was prepared and transmitted to Mr. Hanes on September 14, 1939, which disclosed that the matter of criminal prosecution was receiving consideration in the Bureau. Deficiencies in tax aggregating \$130,955.60, plus 50% ad valorem penalty of \$67,081.98 had been proposed to be asserted, the additional income upon which such deficiencies resulted arising from failure to report profits from certain stock transactions and the understatement of profits returned on other transactions. The unreported profit from stock transactions was in excess of \$1,000,000.



TREASURY DEPARTMENT  
WASHINGTON

146

OFFICE OF  
COMMISSIONER OF INTERNAL REVENUE

JAN 17 1940

ANSWERS REPLY TO  
COMMISSIONER OF INTERNAL REVENUE  
AND REFER TO:

MEMORANDUM for the Secretary:

Referring to your request for a statement in respect of certain cases disposed of by Mr. Hanes, while Under Secretary, your attention is directed to the Act of August 11, 1939 (Public - No. 400 - 76th Congress), providing for the refund of the internal Revenue tax paid on spirits lost or rendered unmarketable by reason of the floods of 1936 and 1937 where such spirits were in the possession of the original taxpayer or rectifier for bottling or use in rectification.

This Act was introduced as Bill H. R. 1648 in the House of Representatives on January 4, 1939, by Mr. Crowe of Indiana, and was referred to the Committee on Ways and Means.

On January 23, 1939, the Chairman of that Committee requested this Department to furnish a report on this bill. On March 4, 1939, in a letter signed by Mr. Hanes, Acting Secretary, the Department recommended that the bill not be passed because it was admittedly for the relief of one taxpayer (Joseph E. Seagram & Sons, Incorporated), and in derogation of the general law applicable to all other taxpayers. A copy of this letter is attached. It should be stated, however, that two small claims have been filed by other companies, which apparently come within the provisions of the Act entitling the claimants to refund.

In spite of the objections of the Treasury Department, the bill passed the House on July 25, 1939. On August 4, 1939, it passed the Senate by unanimous consent, with an amendment which became Section 2 of the Act relating to the collection of certain Social Security taxes. On August 5, 1939, the House concurred in the amendment, completing Congressional action on the bill.

On August 7, 1939, the Bureau of the Budget requested the Department to furnish comments for the purpose of reporting to the President whether there was any objection to the approval of the Act.

The matter was referred to this Bureau and a letter, accompanied by a memorandum of disapproval, was prepared for the signature of the Administrative Assistant to the Secretary and addressed to the Director of the Bureau of the Budget, in which the views expressed in the Department's letter of March 4, 1939, were restated and it was recommended that the enrolled enactment not be approved. A copy of this letter and the memorandum of disapproval are attached.

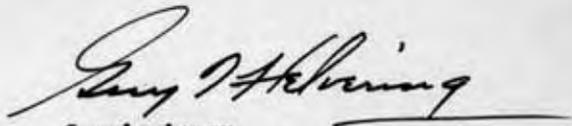
On August 9, 1939, Mr. Hanes held a conference in his office which included Mr. Thompson, Mr. Berkshire, Mr. Young and me, which he opened by presenting a letter he had prepared for his signature, taking the opposite view and not recommending Presidential disapproval of the enrolled bill. After reading his letter, I asked if the purpose of the conference was to request us to approve his letter and he answered in the affirmative, stating that he did not think the Department should present opposing views. I opposed his action in strong terms, but was unable to dissuade him from the position he had taken, except that he did state that he would forward with his letter a copy of the memorandum prepared by the Bureau. Copy of Mr. Hanes' letter is attached.

On August 9 or 10, following the conference, Mr. Young telephoned Mr. Berkshire that he had prepared a memorandum covering the conference and was sending a copy to him for his files. Copy of this memorandum, dated August 9, 1939, is also attached.

The bill was approved by the President on August 11, 1939. It appears from the "Statement by the President on approving H. R. 1648" that he hesitated to sign the Act for two reasons, the first of which is applicable to this matter. A copy of the statement is attached.

On September 8, 1939, Joseph E. Seagram & Sons, Incorporated, filed a claim for refund of \$310,233.32.

On the same date Julius Kessler Distilling Company, Incorporated, (an affiliate of Joseph E. Seagram & Sons, Incorporated), filed a claim for refund of \$113,420.50. These claims were supported by voluminous documents which were forwarded to the District Supervisor, Alcohol Tax Unit, Chicago, Illinois, for audit and investigation. A complete report was furnished by the District Supervisor and since it appeared that all requirements of the statute had been met, each claim was allowed on November 24, 1939, and checks covering these amounts were issued on December 14, 1939.

  
Commissioner.

August 11, 1939

STATEMENT BY THE PRESIDENT  
ON APPROVING H. R. 1648.

"An Act to refund tax paid on spirits lost by reason of the floods of 1936 and 1937."

I hesitated to sign this act for two reasons:

(1) It differentiates between original taxpayers where distilled spirits were lost or destroyed because of an Act of God, and others not original owners who through flood lost similar property. This is, at least, a form of discrimination. Furthermore, I doubt whether the government should refund taxes after the goods taxed have passed into the commerce of the country.

(2) An amendment was added to this bill on the floor of the Senate exempting retroactively from social security taxes those who, directly or indirectly, helped in salvaging timber damaged by hurricane. This, in effect, is a whittling away at the Social Security Act itself. That Act should be extended to more people than it now covers.

However, the actual effect of this bill will not be extensive and I am signing it only with the suggestion to the next Congress that the bill raises definite doubts as to the advisability of extending its purposes to similar cases in the future.

FRANKLIN D. ROOSEVELT.

March 4, 1939

AT:L:ONF

My dear Mr. Chairman:

Further reference is made to your letter of January 23, 1939, requesting the comments or recommendations of this Department with respect to the passage of bill H. R. 1648, and such information and comments as I may care to make relative to the questions raised by Mr. Boehne in his letter of January 20, 1939, addressed to you and referred to me. The purpose of the bill is to provide for the refund or credit of tax paid on spirits lost or rendered unmarketable by reason of the floods of 1936 and 1937 where such spirits were in the possession of the original taxpayer or rectifier for bottling or use in rectification under Government supervision as provided by law and regulations.

The proposed legislation is solely for the relief of original taxpayers and rectifiers whose distilled spirits were lost or destroyed, or rendered unmarketable or useless by reason of the floods, and offers or proposes no relief for others who, by reason of the same floods, suffered the loss of, or damage to, their distilled spirits. The proposed legislation therefore discriminates between the classes of persons whose liquor was lost or destroyed or rendered unmarketable or useless. It further discriminates between losses involving liquor and other property, in favor of the losses involving the former.

The proposed legislation purports, on its face, to be a general relief bill for the benefit of a whole class of persons. This class is described in general terms only and might therefore reasonably be expected to be a large one. In fact, however, as set forth in Mr. Boehne's letter to you, the bill is substantially for the benefit of a single individual, the Seagram Company.

There are no statistics available in the Department to indicate the amount of taxes paid on distilled spirits, wines, fermented malt liquor, and other property lost by reason of the floods while in the possession of dealers and others, but it can safely be assumed that during a flood of the proportions of those of the Ohio and Mississippi Rivers in January and February 1937, such losses were of huge proportions.

It would, of course, present an administrative problem of great magnitude to enact legislation which would authorize the refund of all taxes paid on all property lost or destroyed during such floods. Such legislation would necessarily open wide the door to those of a mind to defraud the government. The number of claims submitted and the volume of investigative work required on such claims would severely tax the resources of the Bureau of Internal Revenue. The proposed legislation contemplates the refund of taxes to those of two classes only to whom the taxpaid spirits may be traced through the records of the Bureau of Internal Revenue. In our opinion legislation designed to sanction refunds to those whose losses can be proved through the use of official records while denying authority to make refunds to those whose bona fide losses are not provable through the use of such official records is neither fair nor just. Enactment of this legislation either in the form proposed or if broadened to afford relief to all whose taxpaid property was lost or damaged, would create an undesirable precedent for other legislation for refund of taxes paid on property of all kinds which may be destroyed or damaged after taxpayment and withdrawal from the custody and control of the United States.

Property of all kinds is forever subject to loss and damage. Fires, floods, storms, and the hazards of transportation take a huge toll each year from the business people of the country. Many losses are covered by insurance, but where not so covered the losses fall heavily and with undiminished force upon the persons whose property was lost or damaged. The United States cannot be an insurer of the taxpaid liquor in the control of the distiller or rectifier any more than it can be the insurer of the buildings or machinery with which they prepare such liquor for the market. The distillers and rectifiers are, it seems, in no different position than the importer

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of fine fabrics whose property, after duty payment, was lost or destroyed by reason of the floods. Such an importer is in no different position than the manufacturer or possessor of fine domestic fabrics lost or destroyed in the same floods. There seems to be no easily discernible connection between the payment of the tax on liquor and the refunds or credits proposed by the bill. The liquors involved had been removed from the custody and control of the United States and, having entered into the commerce of the country, should be accorded the same treatment as all other objects of commerce.

In his letter of January 20, 1939, addressed to you, Mr. Boehne propounded six questions, which I shall set down hereafter and discuss.

1.- Is it true that all distilled spirits that are in a rectifying plant are under the constant supervision and control of the Bureau of Internal Revenue?

The answer to this question must be in the negative. Rectifying plants are constructed and operated in accordance with regulations promulgated by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury. Each rectifying plant consists of three departments, each of which departments may consist of one or more rooms or floors of a building. One of the departments is the "Receiving Room", another is the "Rectifying Room", and the third is the "Finished Products Room". All distilled spirits or wines coming into the possession of the rectifier at the rectifying plant are required to be deposited in the Receiving Room and proper record thereof made. Distilled spirits, or wines, which are to be rectified are dumped into rectifying or mixing tanks pursuant to approval of applications for permission to rectify. Records are made of the spirits or wines and other materials dumped for rectification; of the volume of the rectified product; and of the packaging thereof in bottles, barrels, etc. Neither the rectifying plant as a whole, nor the processing tanks, are locked, but the bottling tanks are so equipped as to permit locking of the inlets and outlets thereof, and the keys to the locks used in such places are in the possession of the internal revenue storekeeper-gauger.

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Therefore, the proprietor of the rectifying plant has ready and free access at all times to the entire plant, and to the spirits and wines therein, with the single exception of the spirits or wines in the locked bottling tanks. The finished product, when bottled or barreled, is removed from the Rectifying Room to the Finished Products Room.

In addition to the processes of rectifying spirits and wines, and bottling such rectified spirits and wines, rectifiers receive, ordinarily, a large quantity of spirits and wines which they bottle without rectification. All spirits, rectified or unrectified, bottled in a rectifying plant are required to be in liquor bottles procured pursuant to Joint Resolution of June 18, 1934, and Treasury Regulations No. 13, and must bear the stamp required under the Liquor Taxing Act of 1934.

Aside from the control of the bottling tanks mentioned heretofore, there is no physical control of the rectifying plant except during the daylight hours when an internal revenue storekeeper-gauger is on duty at the plant. The primary control of the rectifying plant is through the accounting system and audit of the storekeeper-gauger's records and reports, plus periodic visits by inspectors.

The basic taxes on distilled spirits and wines which are handled by a rectifier have been paid, and the interest of the government in the rectifying plant is three-fold; (1) collection of the rectification tax of 30 cents per proof gallon on spirits and wines rectified; (2) compliance by the rectifier with the law and regulations pertaining to containers; and (3) compliance with the law in respect of strip stamps on containers of spirits. Otherwise, the government has no interest in the rectifying plant, and the rectifier is at liberty to use it, subject to regulations, whenever he wishes. It may be said very definitely, therefore, that the distilled spirits which are in a rectifying plant are under the supervision and control of the Bureau of Internal Revenue only during the daylight hours.

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2.- Is it true that through the Government records, every gallon of distilled spirits can be accounted for at all times so that any losses occurring in the rectifying plant will be provable by Government records?

In the light of the discussion of question 1 just above, the answer to this question is in the negative. In the answer to question 1 there was discussed the freedom of access to the rectifying plant, and it is that access which warrants the negative answer.

3.- Is it true that the present laws provide for abatement or refunds of taxes on distilled spirits in case of loss or disaster without fraud or collusion in distilleries and warehouses and during transfers in bond, but there is no provision for losses or casualties sustained in a rectifying house?

It is not true that the present laws provide for refunds in the manner set forth in the question. Herein lies the point of distinction between the abatement provided by the present laws and the refunds which the proposed bill would authorize. In the case of losses in the distillery, the tax which attached to the spirits immediately they came into existence, while ascertainable at any time through audit of the distillery records, has not been ascertained. In the case of losses in the warehouse, and during transfer in bond, the amount of tax due has been ascertained as to each package, but the tax has not yet been paid. Distilled spirits on which the tax has not been paid are in bond. If the object of the taxation is destroyed at distilleries and warehouses and during transfers in bond, there is in existence a very definite record of the quantity thereof and the tax due thereon, and, since no money has passed, it is possible, with a measurable degree of safety to the revenue, to forgive the tax in the manner provided by law and mark the records accordingly.

4.- Is it not true that the present laws provide that after beer has been tax paid and a loss occurs, or the beer becomes spoiled while still in the possession of the taxpayer, refund of the excise tax paid is permitted?

The statement set up in this question is substantially true, but the allowance of the refund is hedged about by conditions which place the brewer whose beer has become spoiled in a situation which is vastly different from the situation of the beneficiary under the proposed bill. Section 327 of the Liquor Tax Administration Act (U. S. C., Sup. III, title 26, sec. 1330b), provides for the refund mentioned.

"\* \* \* upon the filing of a claim therefor by the brewer and proof by him to the satisfaction of the Commissioner that such beer, lager beer, ale, porter, or other similar fermented malt liquor (1) was fully tax-paid, (2) was lawfully removed from his brewery to his bottling house on or after March 22, 1933, (3) never was removed from such bottling house, except in the process of destruction or for return to the brewery, (4) had become unsalable without fraud, connivance, or collusion on his part, and (5) was destroyed by him in such bottling house in the presence of a representative of the Bureau of Internal Revenue, or was returned from such bottling house to the brewery in which made for use therein as brewing material."

In the case of the brewer, the taxpaid article passes through a meter and the exact quantity thereof is a matter of record; it has not left the place in which it was bottled; and no allowance or refund is made to the brewer unless the destruction of the article is accomplished in the presence of a representative of the Bureau of Internal Revenue, or the taxpaid material is returned to the brewery for further use as brewing material. In either event, such representative ascertains the exact quantity so destroyed or returned, and that it is the article which passed through the meter. This type of refund presents practically no hazard to the revenue.

5.- Is it not true that under the present law, taxes are remitted or refunded in the event of loss of brandy intended for fortification of wine from storage tanks in bonded warehouses or from steel drums filled therefrom while such drums are in such warehouse, and in the fortification room of a bonded winery, provided there is no negligence, fraud or collusion?

The answer to this question is in the affirmative, so far as concerns the remission or abatement of the tax. However, brandy intended for fortification, whether in the warehouse or in the fortification room of a bonded winery, is not a taxpaid spirit. If in a warehouse, the tax thereon is covered by the bond of the warehouseman and the lien of the United States for the taxes on such brandy attaches not only to the brandy but to the warehouse building. When brandy is withdrawn by a winemaker for fortification of wine on bonded winery premises, it is subject to a tax of 10 cents per proof gallon when used in the fortification of wines, or at the rate of \$2.00 per proof gallon if not so used, and the payment of the tax at either rate is covered by the bond of the winemaker.

The fortification room is under the lock of the United States, with the key thereto in the possession of its representative. The winemaker is afforded access to the spirits therein only in the presence of such representative; records of the winemaker's removal of the spirits are made by the storekeeper-gauger; and the winemaker is required to account for the use of the spirits for fortification before it is charged to him at the 10-cent rate. The payment of the tax on brandy used in fortification is postponed, by statute, for a period of eighteen months. In any event, complete government records exist covering all brandy removed, and used, for fortification, and the losses allowed by law must be proved to the Commissioner before the tax on the spirits lost is remitted or abated. The use of the word "refund" is not strictly accurate because the tax is not paid immediately upon withdrawal for fortification, but is merely charged against the winemaker under his bond.

6.- Is it true that present laws provide for a refund of taxes paid on tobacco which is lost or destroyed while in the possession of the taxpayer?

The procedure in respect of tobacco is such that the answer to No. 6 is substantially in the affirmative. The taxes on tobacco, snuff, cigars, and cigarettes are paid by stamps which have a money value. Section 1 of the Act of May 12, 1900 (U. S. C. title 26, sec. 1424), authorized the Commissioner

of Internal Revenue to make allowance for or redeem such of the stamps, issued under authority of the law, to denote the payment of any internal revenue tax, as may have been spoiled, destroyed, or rendered useless or unfit for the purpose intended, or for which the owner had no use, or which through mistake may have been improperly or unnecessarily used, or where the rates or duties represented thereby had been excessive in amount, paid in error, or in any manner wrongfully collected.

By the Act of March 3, 1931, it was further provided that internal revenue stamps affixed to packages of tobacco, snuff, cigars, or cigarettes which, after removal from the factory or customhouse for consumption or sale, and which the manufacturer or importer withdrew from the market might, under regulations prescribed by the Commissioner, be redeemed. It is to be noted (1) that the procedure in respect of tobacco, snuff, cigars, and cigarettes withdrawn from the market is not by way of a refund of the tax paid, but by a redemption of the tax stamps which have a money value, and (2) that the procedure (substantially a refund) is authorized by a statute which limits the redemptions to the tax stamps on the four commodities specifically named in the statute. The stamp placed on a package of distilled spirits at the time of the withdrawal of the spirits from bond indicates exactly, as in the case of stamps for tobacco, snuff, cigars, and cigarettes, the amount of tax paid on spirits. As to the four commodities mentioned, the refund of the tax (redemption of the stamps) is accomplished under a statute representing the will of Congress whereby all manufacturers and importers of the four commodities were, in 1931, placed in the same position in respect of the privilege of redemption, whereas it is the purpose of the proposed bill to grant to a single taxpayer a privilege which has been denied others. Since the law is silent as to refunds of the distilled spirits tax in cases where there have been destructions of taxpaid spirits, it follows that there can be no refunds without statutory authority therefor.

This Department considers this bill, which is admittedly for the relief of one taxpayer in respect of losses of taxpaid spirits in a specified manner in certain years, to be in derogation

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of the general law applicable to all other taxpayers. It is our opinion that this bill ought not to be passed, and it is so recommended.

Mr. Boehne's letter is returned herewith.

The Department has been advised by the Bureau of the Budget that there would be no objection to the presentation of this report.

Very truly yours,

(Signed) John W. Hanes  
Acting Secretary of the Treasury.

Honorable Robert L. Doughton,  
Chairman, Committee on Ways and Means,  
House of Representatives,  
Washington, D. C.

Enclosure No. 115

mec  
typed 1/30/39

My dear Mr. Smith:

Reference is made to letter of August 7, 1939 from Assistant Director Bailey, of your Bureau, submitting facsimile of enrolled enactment (H. R. 1648) received at your office for the purpose of reporting to the President thereon as to whether there is any objection to its approval.

Section 1 of the enactment authorizes and directs the Commissioner of Internal Revenue "to make refund, or in lieu thereof, if he so elects, allow credit in the amount of the internal revenue tax paid on spirits previously withdrawn and lost or rendered unmarketable or useless by reason of the floods of 1936 and 1937 while such spirits were in the possession of the person originally paying the said tax on such spirits, or while such spirits were in the possession of the rectifier for rectification or for bottling, or which had been used in the process of rectification, under Government supervision, as provided by law and regulations," etc.

It will be noted that the above provision is solely for the relief of original taxpayers and rectifiers whose distilled spirits were lost or destroyed or rendered unmarketable or useless by reason of the floods of 1936 and 1937, and offers or affords no relief for others, who, by reason of the same floods, suffered the loss of, or damage to, their distilled spirits. The proposed legislation, therefore, discriminates between the classes of persons whose liquor was lost or destroyed, or rendered unmarketable or useless. It further discriminates between losses involving liquor and other property in favor of losses involving the former.

The Department reported adversely on the Bill March 4, 1939 to the Chairman of the Committee on Ways and Means, House of Representatives. The original of that report was transmitted to your office February 1, 1939. As explained in said report the Department considered that Section 1 of the Bill, admittedly for the relief of one taxpayer in respect of losses of taxpaid spirits in a specified manner in certain years, is in derogation

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of the general law applicable to all other taxpayers and recommended that such legislation be not enacted. Section 2 was inserted subsequent to Department report on the Bill.

Section 2 of the Bill provides that no tax shall be collected under Title VIII or IX of the Social Security Act or under the corresponding provisions of the Internal Revenue Code with respect to services rendered prior to January 1, 1940, in the employ of the owner or tenant of land, in salvaging timber on such land or clearing such land of brush and other debris left by a hurricane, and that any such tax heretofore collected (including penalty and interest) with respect to such services shall be refunded, without allowance of interest, in accordance with the provisions of law applicable in the case of erroneous or illegal collection of the tax. The section further provides that no payment shall be made under Title II of the Social Security Act with respect to the services so accepted.

The position of the Department is likewise adverse to Section 2 of the enrolled enactment. The reasons for such adverse position are set forth in attached Memorandum of disapproval. Certain of the comments regarding Section 2 are based upon the assumption that the President will approve H. R. 6635, the Social Security Act Amendments of 1939.

The Department is of opinion that enrolled enactment (H. R. 1648) should not be approved.

Very truly yours,

By direction of the Secretary:

Administrative Assistant  
to the Secretary.

Mr. Harold D. Smith,  
Director, Bureau of the Budget,  
Washington, D. C.

Enclosure No. 900.

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AT:L:BWA

Memorandum of disapproval:

I am withholding my approval from enrolled enactment (H.R. 1648),

"To provide for the refund or credit of the internal revenue tax paid on distilled spirits lost or rendered unmarketable by reason of the floods of 1936 and 1937 where such spirits were in the possession of the original taxpayer or rectifier for bottling or use in rectification under government supervision as provided by law and regulations," etc.

Section 1 of the enactment would authorize and direct the Commissioner of Internal Revenue "to make refund, or in lieu thereof, if he so elects, allow credit in the amount of the internal-revenue tax paid on spirits previously withdrawn and lost or rendered unmarketable or useless by reason of the floods of 1936 and 1937 while such spirits were in the possession of the person originally paying the said tax on such spirits, or while such spirits were in the possession of a rectifier for rectification or for bottling, or which have been used in the process of rectification, under Government supervision as provided by law and regulations."

This provision is solely for the relief of original taxpayers and rectifiers whose distilled spirits were lost or

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destroyed, or rendered unmarketable or useless by reason of the floods, and offers or affords no relief for others who, by reason of the same floods, suffered the loss of, or damage to, their distilled spirits. It, therefore, discriminates between the classes of persons whose liquor was lost or destroyed or rendered unmarketable or useless. It further discriminates between losses involving liquor and other property, in favor of the losses involving the former.

Property of all kinds is subject to loss and damage. Fires, floods, storms, and the hazards of transportation take a toll each year. Many losses are covered by insurance, but where not so covered the losses fall with undiminished force upon the persons whose property was lost or damaged. The United States cannot be an insurer of the taxpaid liquor in the control of the distiller or rectifier any more than it can be the insurer of the buildings or machinery with which they prepare such liquor for the market. The distillers and rectifiers are, it seems, in no different position than the importer whose property, after duty payment, was lost or destroyed by reason of the floods. Such an importer is in no different position than the manufacturer or possessor of domestic fabrics lost or destroyed in the same floods. The liquors involved had been taxpaid and removed from the bonded

Memorandum of disapproval.

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warehouse, where they were in the exclusive custody and control of the United States, and, having entered into the commerce of the country, should be accorded the same treatment as all other objects of commerce, notwithstanding that they were at the time of loss, in the possession of the taxpayers specified.

The above provision (Section 1) contemplates the refund of tax to those of two classes only to whom the taxpaid spirits may be traced through the records of the Bureau of Internal Revenue. Legislation designed to sanction refunds to those whose losses can be proved through the use of official records while denying authority to make refunds to those whose bona fide losses are not provable through the use of such official records is neither fair nor just.

Said provision, admittedly for the relief of one taxpayer in respect of losses of taxpaid spirits in a specified manner in certain years, is considered to be in derogation of the general law applicable to all other taxpayers.

Section 2 of the bill provides that no tax shall be collected under Title VIII or IX of the Social Security Act or under the corresponding provisions of the Internal Revenue Code with respect to services rendered prior to January 1, 1940, in the employ of the owner or tenant of land, in salvaging timber on such land or clearing such land of brush and other debris left by a

Memorandum of disapproval.

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hurricane, and that any such tax heretofore collected (including penalty and interest) with respect to such services shall be refunded, without allowance of interest, in accordance with the provisions of law applicable in the case of erroneous or illegal collection of the tax. The section further provides that no payment shall be made under Title II of the Social Security Act with respect to the services so excepted.

Included in the exemptions from social security taxes in the original Social Security Act are agricultural labor and domestic service in or about a private home, and, in the case of old-age insurance taxes, casual labor not in the course of the employer's trade or business. While the Treasury Department has taken the position that services performed in connection with forestry and lumbering (including the salvaging of timber) do not constitute agricultural labor under the original Act even though rendered in the employ of a person who is also a farmer, services by employees of the owner or tenant of a farm in connection with the removal of brush and other debris from lands of the farm that are used for ordinary farming operations are exempt. Thus certain of the services now sought to be exempted are already exempted either as being agricultural, domestic, or casual. However, it is probable that the exempted services constitute

Memorandum of disapproval.

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only a small portion of the total services which would be excluded from coverage by section 2 of H. R. 1648.

A statutory definition of agricultural labor is included in H. R. 6635 (76th Congress, 1st session), the Social Security Act Amendments of 1939. Agricultural labor will, under the definition, include all services performed in the employ of the owner or tenant or other operator of a farm in salvaging timber or clearing land of brush and other debris left by a hurricane, if the major part of such service is performed on a farm. This is effective, however, only with respect to service performed after December 31, 1939, and, as will be noted, applies only in the case of farmers. Section 2 of H. R. 1648, on the other hand, while it would apply to farmers, is not limited to them, but would apply as well to commercial and industrial establishments. Thus, the regular employees of a business concern would lose coverage for the time that they performed the services described in the section.

Section 2 of H. R. 1648 would provide a special retroactive exemption for the benefit only of a particular class of taxpayers. The exemption, if approved, undoubtedly would encourage others to seek the enactment of special retroactive exemptions not only with respect to services rendered in connection with disasters other than hurricanes but also with respect to services which have been covered since the inception of the Social Security Act but which

Memorandum of disapproval.

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will be excepted on and after January 1, 1940, under the provisions of the Social Security Act Amendments of 1939, for example, services performed in connection with the production of maple sirup or maple sugar, cotton ginning, and fur farming, and certain services performed by students, newsboys, student nurses, and internes. The adding of such retroactive exemptions would prove costly in that it would call for the reopening and reconsideration of cases previously closed, the adjustment of claims, the abatement of assessments, and the payment of refunds.

For the reasons stated above, I withhold my approval.

August 9, 1939

Sir:

Reference is made to Assistant Director Bailey's letter of August 7, 1939, transmitting a facsimile of enrolled bill H. R. 1648, to provide for the refund or credit of the internal-revenue tax paid on spirits lost or rendered unmarketable by reason of the floods of 1936 and 1937 where such spirits were in the possession of the original taxpayer or rectifier for bottling or use in rectification under Government supervision as provided by law and regulations, and requesting the comments of this Department on the enrolled enactment.

Section 1 of the enrolled bill would authorize and direct the Commissioner of Internal Revenue "to make refund, or in lieu thereof, if he so elects, allow credit in the amount of the internal-revenue tax paid on spirits previously withdrawn and lost or rendered unmarketable or useless by reason of the floods of 1936 and 1937 while such spirits were in the possession of the person originally paying the said tax on such spirits, or while such spirits were in the possession of a rectifier for rectification or for bottling, or which have been used in the process of rectification, under Government supervision as provided by law and regulations."

With the approval of the Bureau of the Budget this Department, under date of March 4, 1939, reported adversely on the foregoing provision to Chairman Doughton of the House Committee on Ways and Means.

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The principal basis of the Department's objection, as explained in that report, was that this provision, admittedly for the relief of one taxpayer in respect of losses of taxpaid spirits in a specified manner in certain years, was in derogation of the general law applicable to all other taxpayers. The Department, therefore, recommended that such legislation be not enacted. The Ways and Means Committee gave the most careful consideration to the Treasury Department's views on the bill. The carefulness of this consideration is strikingly evidenced by the Committee's report on the bill (House Report No. 1268, 76th Congress) which sets out the Department's report in full and in a parallel column analyzes our report point by point and incorporates material intended to refute each objection made to the bill by the Treasury. Only one member of the Ways and Means Committee, Mr. Cooper, dissented from the Committee's favorable report to the House on H. R. 1648. The bill passed the House on July 25 by unanimous consent with both democratic and republican members of the Ways and Means Committee supporting it on the floor. The fact that the Treasury Department reported unfavorably on the bill was referred to in the debate on the floor. The Senate Finance Committee reported the bill favorably on July 27 (Senate Report No. 983, 76th Congress). In so doing, the Committee adopted the House Ways and Means Committee report on the bill. On August 4 the bill passed the Senate by unanimous consent with an amendment which became section 2 of the present enrolled enactment which will be discussed below. The next day the House concurred in the amendment, completing congressional action on the bill.

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While the Treasury Department's views as to the merits of the provisions of section 1 of the bill have not changed since its report on them of March 4, 1939 to the Ways and Means Committee, in view of the fact that that Committee gave the most careful consideration to these views and nevertheless reported favorably on the bill, and in view of the fact that Congress adopted the views of the Ways and Means Committee and enacted the bill, this Department will not recommend Presidential disapproval of the bill because of the presence of these provisions in it.

Section 2 of the enrolled bill provides that no tax shall be collected under Title VIII or IX of the Social Security Act or under the corresponding provisions of the Internal Revenue Code with respect to services rendered prior to January 1, 1940, in the employ of the owner or tenant of land, in salvaging timber on such land or clearing such land of brush and other debris left by a hurricane, and that any such tax heretofore collected (including penalty and interest) with respect to such services shall be refunded, without allowance of interest, in accordance with the provisions of law applicable in the case of erroneous or illegal collection of the tax. The section further provides that no payment shall be made under Title II of the Social Security Act with respect to the services so excepted.

Certain of the services now sought to be exempted by section 2 are already exempted under existing law either as being agricultural, domestic, or casual. However, it is probable that the exempted services constitute only a small portion of the total services which would be excluded from coverage by section 2 of H. R. 1648.

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A statutory definition of agricultural labor is included in H. R. 6635 (76th Congress, 1st session), the Social Security Act Amendments of 1939. Agricultural labor will, under the definition, include all services performed in the employ of the owner or tenant or other operator of a farm in salvaging timber or clearing land of brush and other debris left by a hurricane, if the major part of such service is performed on a farm. This is effective, however, only with respect to service performed after December 31, 1939, and, as will be noted, applies only in the case of farmers. Section 2 of H. R. 1648, on the other hand, while it would apply to farmers, is not limited to them, but would apply as well to commercial and industrial establishments. Thus, the regular employees of a business concern would lose coverage for the time that they performed the services described in the section.

Section 2 of H. R. 1648 would provide a special retroactive exemption for the benefit only of a particular class of taxpayers. The exemption, if approved, undoubtedly would encourage others to seek the enactment of special retroactive exemptions not only with respect to services rendered in connection with disasters other than hurricanes but also with respect to services which have been covered since the inception of the Social Security Act but which will be excepted on and after January 1, 1940, under the provisions of the Social Security Act Amendments of 1939, for example, services performed in connection with the production of maple sirup or maple sugar, cotton ginning, and fur farming, and certain services performed by students, newsboys, student nurses, and internes. The adding of such retroactive exemptions would prove costly in that it would

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call for the reopening and reconsideration of cases previously closed, the adjustment of claims, the abatement of assessments, and the payment of refunds.

Section 2 was added to the bill by Senator Austin on August 4 on the floor of the Senate after the bill had passed the House and been reported by the Senate Finance Committee. Senator Austin's amendment grew out of a discovery in the conference meetings on the Social Security bill that an amendment which he had offered, which was finally accepted as part of that bill as it went to the President, was not retroactive as he had supposed. Senator Austin's amendment to the Social Security bill has been explained above. At the time of the discussion on the floor of the Senate of Senator Austin's amendment to H. R. 1648, the majority leader, Senator Barkley, indicated his willingness to accept the amendment and also stated that he had information that the House was willing to accept it. The bill accordingly passed the Senate with the Austin amendment and the next day the House concurred in the amendment.

In view of all the circumstances, the Treasury Department is not disposed to recommend Presidential disapproval of enrolled bill H. R. 1648.

Very truly yours,

(Signed) - John W. Hanes,

Acting Secretary of the Treasury.

The Director,

Bureau of the Budget.

August 9, 1939

## MEMORANDUM FOR THE FILES

Re H. R. 1648

Revenue prepared a letter on this bill, a copy of which is in the file, recommending that it be vetoed by the President. Mr. Hanes called my office and requested that the whole file be referred to him before anything was sent to Budget. We referred the file to him on August 8. On the morning of August 9, Mr. Thompson came down and said that Mr. Hanes had asked him to have us prepare a letter to Budget saying in effect that the Treasury was not disposed to recommend a veto message. He wanted as strong a letter justifying that position as could be written. We prepared such a letter and sent it up to him. In the afternoon of August 9, he conferred with Mr. Thompson, Mr. Helvering and Mr. Berkshire but could not convince them that the second letter should be sent. Notwithstanding their position, he signed the second letter. However he told Mr. Thompson to send a copy of the Revenue letter and veto message to Budget along with the letter he signed. I called Mr. Bailey of the Budget and told him that we were sending along Mr. Hanes letter plus copies of the letter which had been prepared by Revenue and the veto message. Mr. Bailey said that Budget could not tell the President that the position of the Treasury was any different than that indicated by the letter which Mr. Hanes signed. He said,

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however, that they would adopt the veto message as Budget's and send it to the President, with the suggestion that it be used if he decided that he wanted to veto the bill.

(Init.) L. J. B.

## GROUP MEETING

January 17, 1940.  
9:30 a.m.

Present: Mr. Bell  
Mr. Foley  
Mr. Graves  
Mr. Schwarz  
Mr. Thompson  
Mr. Gaston  
Mr. Harris  
Mr. Cochran  
Mr. Cotton  
Mr. Haas  
Mr. White  
Mr. Sullivan  
Mrs Klotz

H.M.Jr: Herbert?

Gaston: I have nothing.

H.M.Jr: I got this memo from the President. I will read it. Where is Sullivan?

Nothing?

Gaston: Nothing, no.

H.M.Jr: Ed? If you will stay behind afterward, I want to talk to you.

Foley: The Bank of America has confirmed the letter Collins wrote to the Fed asking for an independent examination. Collins asked for a copy of the notice of hearing. I don't see any reason why, since we have a written record, we shouldn't give it to him.

H.M.Jr: They are asking the Fed now?

Foley: Yes. The Board of Directors adopted a resolution that the meeting on the - right after the stockholders' meeting that confirmed the letter that Collins had written to the Fed, asking for an independent examination.

H.M.Jr: Now, the next thing is up to the Fed?

Foley: Yes. They haven't told us what they are going to do yet, although they formerly told us that they had that resolution.

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H.M.Jr: But they haven't told us what they were going to do?

Foley: No.

H.M.Jr: Harry, just read this a minute and see whether the information contained in there is in the Brazil file. Let Cotton read it, too.

Cochran: This one refers to a dispatch. We have been phoning this morning and can't get anything from the State Department on this one to which reference is made in the first line.

H.M.Jr: Is that the one which came up to the house last night?

Cochran: Yes, sir.

H.M.Jr: I just wondered if - they have a file on Brazil and I wondered if that isn't referring to something that we don't know about.

Cochran: That first sentence refers to a dispatch from Brazil which we haven't received yet. I phoned Collado this morning and he isn't in.

White: Yes, they said they had not received the dispatch which is referred to in the last cable.

H.M.Jr: I will talk to you about it afterward.

Cochran: I have nothing.

H.M.Jr: Chick?

Schwarz: There was no story in the Baltimore Sun. Lacking confirmation, they withheld it.

H.M.Jr: The Baltimore Sun called him up and had this idea that I was over at the Martin plant yesterday.

Gaston: They called me up about a rumor of that kind and I didn't know anything about it.

H.M.Jr: They get the silliest ideas.

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Gaston: AP, also. AP was quite persistent.

H.M.Jr: It must have been a fellow that looked like me.

Schwarz: Homer Cummings?

H.M.Jr: Now don't get insulting. I have got hair on my head.

Sullivan, I have a memorandum here from the President which reads as follows:

"Because immediately after March 15th the question will arise as to whether last year's tax bill will cost the Treasury more than expected, I wish you would appoint an informal committee of three consisting of a representative of Internal Revenue, Lauchlin Currie, and the third person to be chosen by them, to make a report to me as soon as possible. This report should cover the tax law change of '39, also the tax law of '38. I take it the tax law change made in '38 will be reflected in the returns this spring.

"It is important both for the Treasury and for me that we get some fairly definite facts on the situation."

Evidently the President is getting a little bit worried about that statement he made in his budget message.

Now, inasmuch as this is both revenue and taxes - it is revenue, isn't it?

Bell: Yes.

H.M.Jr: I am going to ask Dan to sort of act as the head. I want Sullivan on it and I want to ask Mr. Helvering whether he would like to serve or designate somebody and will you (Bell) get in touch with Lauch.

Bell: Yes.

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- H.M.Jr: Because this was quite a slap at the Treasury and evidently the President is getting a little bit worried about it.
- Bell: I suppose that was behind it.
- H.M.Jr: Will you handle that with Sullivan and Helvering and Lauch?
- Bell: Mr. Haas ought to be in on it, as part of our staff.
- H.M.Jr: Yes. But I mean, you get in touch with Lauch and somebody from Mr. Helvering's office. I would do it fairly promptly. I am glad he is doing it that way.
- What else have you got, Sullivan?
- Sullivan: Nothing, except I was wondering if you had had any further conversations with the joint Anglo-French mission.
- H.M.Jr: On what?
- Sullivan: The matter we discussed before. I haven't heard anything from them but the manufacturers are beginning to come around.
- H.M.Jr: No. They are seeing the duPonts now, but they really haven't yet talked to me. They have only really got their instructions now as to what they should or should not buy. I have had nothing on the tax end of it. The only thing that I had was, and I wish you would look this up because I referred them to you, that if an airplane manufacturer gets an order from the Army and let's say he loses \$100,000 on that, on the experimental order, and he has another one from the Navy and he makes \$150,000, he says the way the Act is set up he can't offset one against the other.
- Sullivan: That is right, the way the regulations now read he can not.
- H.M.Jr: Is that fair?

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- Sullivan: The question is whether or not you are going into a guaranteed profit. You see, under the present rates where they are allowed 10 percent of the total contract price, that is 11-1/10th percent profit on the investment. Where it is 12 percent, it is 13.6, I think.
- H.M.Jr: I mean the same company - after all, they are doing business with the United States Government. In the one case they lose money and in the other case they make money. Each one has - they can't offset one against the other?
- Sullivan: They can't offset Army against Navy contracts.
- White: Why should they lose money when they can set the price at any price they want to and the excess is just confiscated? I don't quite understand why they should ever be in a position where they should lose money.
- H.M.Jr: On experimental orders.
- White: I doubt it, Mr. Secretary, by virtue of the fact that they can charge any price that they want to.
- H.M.Jr: Can they?
- White: Yes, because if they make more than the amount, they don't get it.
- Sullivan: They are charging it up pretty well.
- H.M.Jr: I referred it to you. I told them I wasn't familiar with the situation.
- Sullivan: That is the same inquiry the Vice President of Glen Martin made a couple of weeks ago in a letter to you.
- H.M.Jr: I didn't even know that. What was the Vice President's name?
- Sullivan: I don't recall, but there was sent to you a copy of his letter to Congressman Vinson.
- H.M.Jr: Well, that is funny, because in discussing it yesterday - because I didn't know a thing

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about it and Martin didn't seem to know anything about it, either. Anyway, I told them that you were the man to see.

Sullivan: Yes, sir.

H.M.Jr: I think the trouble - the reason you haven't heard more is it is only in the last day or two that the allied purchasing commission really know what they are supposed to buy.

Sullivan: They were very vague a week ago.

H.M.Jr: That is why, they didn't have their definite orders, but they have got their orders on powder now.

Sullivan: I think they are going to try to introduce a bill at this session to allow them to charge off a loss on an Army contract against excess profit on a Navy contract, and vice versa.

H.M.Jr: That is up to you. Let me know what is right, what is fair. You haven't worked for me long enough, but you will never find that I handle any of those things. I never touch them. All right?

Sullivan: Yes, sir.

H.M.Jr: George?

Haas: You wanted this brought in, Mr. Secretary (handing letter to Secretary).

H.M.Jr: Dan, what would you do with this thing? Here is a letter from Henry Wallace to me about Milo Perkins' food tickets. Didn't Harold Graves follow that thing through with me? Who followed that thing on the set-up?

Bell: I think Harold was - headed more or less the committee for a week or so to keep you advised as to what was going on. I have a memorandum here now on it from Bartelt, saying that they are contemplating starting it in rough.

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- H.M.Jr: He said he had sent a copy to White. Isn't this an administrative matter, a matter of set-up, and so forth?
- Bell: Yes. It is entirely up to Agriculture. The only way we get in on it is through our disbursing office.
- H.M.Jr: You see, he talked with White and Bartelt and now he comes and says, "I will appreciate it if you will advise if holding such a conversation meets with your approval."
- White: He says he talked with me?
- H.M.Jr: Yes.
- White: Oh, that was about a month ago when I told you about it and you said several times you wanted to go into it and wanted to talk about it but you kept postponing it, the wisdom of extending that to cotton. At that time, it was only in the planning stage and Milo Perkins spoke to me and I spoke to you and you were going to see Mr. Perkins at that time, but you didn't have an opportunity.
- Bell: Is he asking me to approve....
- H.M.Jr: You handle it, anyway. I am not going to fuss with Milo Perkins or cotton or anything that has got to do with Wallace. We will just take on the certificate plan. You write a letter for my signature.
- White: Last year you expressed tentative approval of that idea.
- H.M.Jr: I know, but I can't work with Wallace. It is impossible to work with him. You work with a man and then he comes out and makes a vicious attack, without naming me, in the papers on this this thing and he is telling all the farmers, and everything, I am against the farmers and all the rest of it. You just can't work with him.

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Basil?

Harris: That plane is still in storage.

H.M.Jr: All right.

Harris: Do you think we ought to remind them? The charges are mounting up on it.

H.M.Jr: Could you get me a little memorandum on it between now and a quarter of 11:00?

Harris: Yes.

H.M.Jr: Will you?

Harris: Yes.

H.M.Jr: I am seeing the President at 11:00 and the heads of the Army and Navy Air Corps are both to be there. It would be an ideal time.

Harris: Yes.

H.M.Jr: It would be an ideal time.

Harris: I will have it for you.

H.M.Jr: Anything else?

Harris: No.

H.M.Jr: Anything new on stuff moving from our borders?

Harris: No. The trade papers are picking up the fact that goods are starting to back up in the South rather badly.

H.M.Jr: Is the Maritime Commission doing anything?

Harris: No, I don't think there is anything they can do at the moment.

H.M.Jr: Anything I can do?

Harris: No. I think it has got to get worse before it

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can get better and then they may decide to sell some of that old laid-up fleet. That is about the only solution that I can see anywhere.

- H.M.Jr: You two gentlemen, Cotton and White, that cable from Brazil, is that in your file?
- White: It sounds new to me but I want to be sure and check up.
- Cochran: Well, it just came in yesterday evening. It is routed to them.
- H.M.Jr: No, I mean this memorandum referred to in there.
- White: I don't remember seeing any reference to it, but I will go through them again. There is a memorandum of Feis' conversation as to what he thought might be done, but it isn't identical with this or even similar. I wouldn't want to say for sure, but I don't recognize anything in it.
- H.M.Jr: Will you two gentlemen see Miss Chauncey and see if there is anything in that memorandum that you are looking for?
- White: Yes, we will do that.
- H.M.Jr: After that, let me know.
- White: Here is the report on the Russian thing. Here is this foreign matter. I don't know whether you want anybody else to get that.
- H.M.Jr: I will read it. Joe, if you will wait outside, when I get through with Foley you come in and I will read the memorandum from Traphagen and I will call him up on the wire while you are here.
- Harold?
- Graves: Nothing.
- H.M.Jr: Dan?

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- Bell: I don't know whether you are familiar with that correspondence we have had with the State Department regarding the account with the Riggs National Bank in the name of the former Spanish Ambassador. I think the first letter went out, didn't it, Ed, and he said that it was a conference between the counsel of the bank and the counsel of the Embassy and that we didn't want to inject the Comptroller into it. Now Mr. Welles comes back and makes a direct request that we examine the account and furnish the Spanish Ambassador the information required.
- H.M.Jr: Will you handle it, getting proper legal advice?
- Bell: I question whether we ought to do it, use bank examining powers.
- Foley: If we got a direct request from the State Department to do it, I think we have got to do it, because we would raise the dickens, Dan, with a foreign power that was directly requested by our State Department to do something like that and they refused to do it.
- Bell: The trouble is, there isn't anything to show that this isn't a personal account. It has all the earmarks of a personal account rather than of an official account. I don't know how you are going to prove that it isn't a personal account.
- H.M.Jr: Well, would you and Ed handle it?
- Bell: Yes.
- H.M.Jr: And you might keep Gaston informed, inasmuch as it is State Department stuff.
- Bell: All right.
- H.M.Jr: It is kind of ticklish. Supposing Bell and Gaston and Foley be a committee of three to handle it, without referring it back.
- Bell: O. K.

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H.M.Jr: What else, Dan?

Bell: That is all I have.

H.M.Jr: It was very encouraging to me - as I understand, either seven or eight letters have come in from individuals in California as a result of that statement I made about the Bank of America and their management, every single one friendly and most of them complaining how through Giannini's interests they have lost their fortunes, but there isn't a single one but says go to it. Everyone is praising me for my stand and it is about time that these fellows - about time the Government did something. It is quite encouraging. The only abuse I get is from Giannini, but from the people - they are with me. It is interesting. Evidently the people believe it is popular in California.

Foley: The Department of Justice says the action they took against Bioff is popular, too.

Gaston: They didn't know that or they would have done it sooner.

Foley: The A. F. of L. is going to pay for his defense.

H.M.Jr: Anything else, Dan?

Bell: No.

White: Before you go on, there is one point I forgot to mention. We have very inadequate figures of British gold. We are only guessing. I wonder whether you feel it feasible to try to get some more information through Butterworth.

H.M.Jr: More what?

White: More accurate figures from Butterworth as to what they have. We don't know. The last one we had was in August and we are trying to guess.

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H.M.Jr: Keep that in the back of your mind and let's wait until Mr. Gifford arrives and maybe we could ask him. He is on the water now.

White: There was a mistake on that chart. That chart was 900 million. It should have been a billion 900 million for England.

H.M.Jr: You see, I said to you when I saw that chart, the most significant thing was the fact of how little - remember, I put my finger right on it, Harry.

White: That is why I went back and looked it up.

H.M.Jr: And in your November report you showed much more. I meant to speak to you.

White: Yes, it was a billion nine, but it is possibly less. We don't know, but that is what our last information is. We think it is almost the same, but we don't know.

H.M.Jr: Well, let's wait until Gifford comes over.

White: You don't feel you want to ask Butterworth to dig around?

H.M.Jr: What do you think?

Cochran: I don't think you should.

H.M.Jr: I don't either.

Are you through, Dan?

Bell: Yes, I am through.

H.M.Jr: How about you?

Thompson: I have a memorandum to General Watson about that gold medal.

H.M.Jr: What they want us to do is to follow it through for them.

Thompson: Yes.

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Here are the commissions for the Undersecretary and the Assistant Secretary. They are ready for signature.

H.M.Jr: Have the two days and all that passed?

Thompson: Yes, they have passed.

Gaston: ✓ Monday and Tuesday.

H.M.Jr: Then the drinks are on Sullivan, and it is not to be tomato juice, either.

When do we swear these boys in, today?

Thompson: I will have to get the commissions signed by the President.

H.M.Jr: Fine. Is everything else all right?

Thompson: Yes, sir.

H.M.Jr: O. K.

## PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Paris, France

DATE: January 17, 1940, 7 p.m.

NO.: 89

FOR THE TREASURY.

FROM MATTHEWS.

Today Dayras, Rist and Couve de Murville had lunch with me at my house. According to Couve, revised estimates indicated that for the month of January payments by France for purchases of war materials in the United States would total about 42 million dollars instead of 45 - reference: telegram of January 10, No. 49, from the Embassy - and that in the months of February and March roughly similar sums would have to be paid.

As yet it is too early to get any idea of what the value of French holdings abroad will be as obtained from the required declarations, and it is probable that it will be March before the "inventory" is ready. Couve said again that he thought French holdings of American securities were certainly not more than our Federal Reserve had mentioned; he said that British gold mine stocks and Royal Dutch were bought mostly with French capital abroad. He said there are indications that there is beginning in France the hoarding of gold and of dollar banknotes particularly, but that there was no sign of any flight from money into goods as yet.

(Personally

(Personally I think that sooner or later a certain amount of this is bound to come). I made the remark that recently I had seen indications that despite lack of published statistics, prices are in fact starting to rise. They all were in agreement that this expected development is putting in an appearance at last, though not on an alarming scale as yet.

The hope was expressed by Rist that in the near future the Government would proceed with extensive rationing plans; he said that "petite bourgeois" are already showing signs of hoarding foodstuffs, as well as small local merchants. He feels that there is an unfortunate effect from these "abuses".

Couve de Murville continues to be pleased with exchange control operation. He said that there are no longer any important loopholes, since Great Britain followed with a regulation similar to theirs for regulation and supervision of franc deposits to foreign accounts - reference, telegram No. 2882 of December 1 from the Embassy. Couve said that he had not seen any concerted effort to violate the control measures. On the contrary, Rist said, he had found a great deal of anxiety on the part of individuals lest they contravene them unwittingly and incur the war time penalties, which are relatively severe. There seems to have been a great change in the traditional French attitude toward fiscal fraud and evasion because of the war, Rist said.

- 3 -

Couve said that there did not seem to be any capital export on an important scale certifying to jewelry purchases, when I asked him about this. Also, both as to smallness of volume and as to rate, he feels that the free market in New York continues satisfactory.

The remark was made by Couve that he believed there was some danger that people in France would get the idea that Germany's defeat could be brought about by economic warfare activity alone; quickly Rist and Dayras spoke up and said that nowhere in the French Blockade Ministry did such an illusion prevail. Both Rist and Dayras severely condemned the attitude of the French information center as evidenced through the radio and through the press in giving an exaggerated picture of the weakness of Germany, and in raising the false hope that all the Allies would have to do would be to sit quietly and relatively safely behind the Maginot Line and that in a short time the blockade would bring about an automatic disintegration of German economy and subsequently capitulation to the Allies. Incidentally, it seemed Couve believed that a period of extended inactivity might well be a more serious problem to the morale of the French than it would prove serious to the Germans.

END SECTIONS ONE TO FIVE, INCLUSIVE.

BULLITT.

EA:LWW

PARAPHRASE OF SECTIONS SIX AND SEVEN OF  
TELEGRAM NO. 89 FROM PARIS, JANUARY 17, 1940.

They said it seems that satisfactory progress is being made in the trade and clearing agreement negotiations, although the Swiss are still causing them some "trouble". They all agree that the one responsible for the "trouble" is Mr. Stucki, the Swiss Minister here, who is the "capable but very difficult" chief delegate. Although in their agreements they are including definite "guarantees" on the part of the neutrals to hold their exports to Germany down to "normal" amounts, they have not as yet dared to go farther than that--they felt that frequently the "guarantee" was illusory and would depend on the "psychology" of the neutral government and the extent to which the government was subservient to pressure by Germany. It was remarked by Rist that a little leverage is given to the Allies by the fact that at the present time they are transporting part of the coal shipments to Italy from Holland in British ships. Although railway freight traffic between Italy and Germany since the beginning of the war has increased 22 percent and therefore indicates some rise, Rist does not feel that Germany is receiving a great deal through Italy. He said they had found out that except for shipments of Hungarian wheat bought by Italy which had been going to

Abyssinia

-2-

Abyssinia by way of the Suez Canal, the port of Trieste is "dead".

It was generally agreed that there had been a marked and encouraging improvement in French exports recently. Rist said that at the present time exports from France to Holland are now as large as they were before the war, and French exports to South America, especially to Argentina, are very satisfactory. The unwillingness of the military censor to allow statistics on foreign trade, prices and other economic and financial indices to be published was criticized by all of them.

BULLITT

EA:EB

CORRECTED COPY

HSM

GRAY

Paris

Dated January 17, 1940

Rec'd 9:30 p. m.

Secretary of State,  
Washington.

89, January 17, 7 p. m. (SECTION EIGHT)

Deposits in the national (postal) savings banks during the period December 16 to 31 totalled 329,000,000 francs and withdrawals 168,000,000. During the entire year of 1939 deposits exceed withdrawals by 662,000,000 francs, the highest for six years.

Deposits in ordinary (private) savings banks during the period December 16 to 31 totalled 218,000,000 and withdrawals 25,000,000. During the entire year of 1939 deposits exceeded withdrawals by 234,000,000.

The French financial press has quoted extensively from British journals on the alleged remarks of Colonel Llewellyn with respect to the future requisitioning by the British Government of foreign securities and the AGENCE ECONOMIQUE ET FINANCIERE has hastened to point out that this would in no way affect the Paris Bourse. As you are aware (my telegram No. 49, January 10, 6 p. m., paragraph two and previous assurances reported) the French Government has no present thought of requisitioning private holdings of foreign securities.

NPL

BULLITT

JT

GRAY

PARIS

Dated January 17, 1940

Rec'd 9:35 p.m.

Secretary of State,  
Washington.

89, January 17, 7 p.m. (SECTION NINE)

After two days of weakness the Paris securities exchange was firmer today. Most rente issues advanced fractionally and the 1937 exchange guaranty issue moved up one franc fifteen centimes to 217. The improvement was due partly to a more optimistic feeling that Holland and Belgium will not be invaded and in part to improved technical position. The carryover rate on Monday's mid-month settlement day was fixed at seven eighths per cent compared to 1% at December 15 and  $2\frac{1}{4}\%$  at the end of December.

Official exchange rates for the belge 733 - 739 (compared with 735 - 741) and for the florin 2322 - 2336 (compared with 2326 - 2340).

(END OF MESSAGE)

BULLITT

NPL

RECEIVED  
DIVISION OF  
INTELLIGENCE  
JAN 17 1940

Prepared by: Mr. Murphy  
Mr. Lindow  
Mr. Tickton  
Mr. Haas

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TREASURY DEPARTMENT

CONFIDENTIAL

INTER OFFICE COMMUNICATION

DATE January 17, 1940

TO Secretary Morgenthau  
FROM Mr. Haas  
Subject: Recent Developments in the Bond Market; Canadian Government Finance

SUMMARY

- (1) Domestic high-grade securities marked time last week. On Monday of this week, however, long-term Governmentals fell sharply, and then held steady on Tuesday. In contrast, high-grade corporates were steady both days (Chart I).
- (2) The average maturity of United States direct debt increased by five months during 1939 to ten years and five months, while the average maturity of direct and guaranteed debt combined increased by one month to nine years and ten months (Chart II).
- (3) The Dominion of Canada offered a new war loan Monday consisting of 3-1/4 percent bonds redeemable by lot in five equal parts annually from 1948 to 1952. The loan is for \$315 millions, of which \$115 millions is offered in exchange for an issue maturing March 1. On a per capita basis, the loan is equivalent to \$3.8 billions in the United States. The rate of 3-1/4 percent is slightly below the market (Chart III). Newspaper reports indicate that the cash subscriptions are heavy and the loan will doubtless be oversubscribed.

The new loan comes on the heels of large increases in the Canadian debt in recent years (Chart IV). The per capita Canadian debt has consistently been larger than that of the United States, although the difference has been growing smaller.

All Canadian Government securities are higher in yield than United States securities of comparable term (Chart III).

In the last year and a half, Canadian long-term bonds have lost ground, on net balance, while United States securities have gained (Chart V).

- (4) British 2-1/2 percent consols and French 3 percent rentes declined, on net balance, by 1 point and 1.65, respectively, on the first two days of this week (Chart VI).

Secretary Morgenthau - 2

### I. Domestic Bond Market

High-grade securities markets in the United States marked time last week. On Monday of this week, however, medium-term and long-term Government securities showed large price declines. Bonds callable in five to fifteen years declined 13/32, and bonds callable after fifteen years, 20/32. High-grade corporate bonds, however, declined only slightly. According to the Federal Reserve Bank of New York, the selling of Governments seemed to be based on the desire to realize profits in view of the unfavorable news received from abroad. In any event, the weakness was arrested on Tuesday, as both Governments and corporates held steady (Chart I).

There were several interesting developments in the financial field last week.

The week was marked by the first case of a Class I railroad to emerge from reorganization proceedings under Section 77 of the Bankruptcy Act, when on Wednesday, January 10, the Court approved the reorganization plan of the Chicago and Eastern Illinois Railroad. It is expected that a few months will elapse, however, before all the legal details are completed.

On Wednesday and Thursday, January 10 and 11, the two top holding companies of the Associated Gas and Electric system filed voluntary bankruptcy proceedings following the action of the SEC in forbidding the payment of dividends or interest by the Associated Gas and Electric Corporation to its parent, the Associated Gas and Electric Company. This blocked the main income source of the parent company which found itself with insufficient funds to meet \$260,000 of interest due on January 15 on its debentures. Under the authority of present legislation, the SEC may be appointed as sole trustee for both companies.

The USHA has announced that a second series of \$35 millions of short-term notes of local housing authorities will be offered in the near future. The first series consisted of \$50 millions of six-month notes sold on November 14 at a rate of just under .60 percent.

New corporate and municipal bond issues for the week ended January 13 were small aside from the \$30 millions offering of the American Gas and Electric Company. This issue was very well received, with special preference shown for the 20 and 30 year maturities.

Treasury bills have continued to flow to Chicago for purposes of tax avoidance. In the week ended January 10, reporting banks in Chicago increased their holdings of bills by another \$69 millions, making a total increase of \$241 millions since December 6.

## II. Increase in Average Maturity of Public Debt

It was pointed out in a memorandum last week (January 10) that as a result of recent financing operations, the composition by maturity classes of direct and guaranteed debt has been altered significantly. Further evidence of these changes is brought out in Chart II, which shows the average maturity of the debt as of the end of each calendar year from 1929 through 1939. In studying the chart, it should be remembered that the mere passage of time automatically reduces the average maturity each year.

The average maturity of the direct debt increased by five months during 1939 to ten years and five months. This compares with a low, for the dates covered in the chart, of seven years and seven months registered in 1934, and a high of eleven years and three months in 1929.

If guaranteed debt is also included, the average maturity for 1939 becomes nine years and ten months, an increase of one month over 1938. It is interesting to observe that the average maturity of direct and guaranteed debt combined was lower in the last two years than the average of direct debt alone; whereas in previous years, the combined average was higher than that of direct debt alone. The average maturity of guaranteed debt has, of course, been reduced greatly in the last two years as numerous short-term issues have been sold.

## III. Canadian Government Finance

### Canadian war loan

The Canadian Federal Government offered its first public war loan Monday. (A previous war loan offered in October 1939 was sold exclusively to banks.) The loan is for \$315 millions, of which \$200 millions is for cash subscription, and \$115 millions for refunding of a 3 percent bond issue maturing March 1. This is a very large issue for Canada, and on a per capita basis is equivalent to \$3.8 billions in the United States. According to press dispatches today, cash subscriptions are heavy and the loan will doubtless be heavily oversubscribed.

The loan will bear 3-1/4 percent interest, which is somewhat below the market yields on existing Canadian securities of comparable maturity (Chart III).

Redemption will be by lot in five equal parts, annually from 1948 to 1952. An interesting device results in providing a slightly higher rate of interest for the parts to be redeemed in 1951 and 1952. Unlike the first three redemptions, which

Secretary Morgenthau - 4

will be at par, the 1951 part will be redeemed at 100-1/2, and the 1952 part at 101. Principal and interest will be payable in Canadian money only.

The subscription lists opened Monday, and will remain open two weeks unless closed earlier by the Minister of Finance. Bonds will be issued in denominations as low as \$50. In order to facilitate purchases, the chartered banks will make three-month loans up to 80 percent of the principal amount of the bonds. These loans will bear interest at 1/4 of 1 percent per annum.

#### Growth of public debt

The new Canadian loan comes on the heels of very large increases in the Dominion debt in recent years. Chart IV compares the direct and guaranteed Federal debt in Canada and the United States from 1914 to date. The scale for the United States is shown on the left-hand side of the chart, while that for Canada is shown on the right-hand side. The Canadian scale has been enlarged twelve times over that for the United States in order to correct for the difference in population. (In both 1920-21 and 1930-31, the respective censuses showed the population of the United States to be approximately twelve times as large as that of Canada.)

It is interesting to note that the curves representing the direct debts of the two countries follow about the same course. The direct debt of both countries increased sharply in the World War years, decreased during the decade of the Twenties, and increased again sharply in the depression years. The Canadian curve, however, is always higher than that for the United States. This is a reflection of the fact that the per capita debt of Canada has been consistently higher than that of the United States. In the last ten years, however, the United States direct debt has increased more sharply than that of Canada.

The comparative situation is not complete, however, unless guaranteed debt is also considered. In the last twenty years, the guaranteed debt of Canada has increased tremendously, principally as a result of a great expansion in the guaranteed railroad debt. It is interesting to note that the decrease in the direct debt of Canada which took place in the Twenties as war debt was retired was more than offset by the huge increase in guaranteed debt. Considering guaranteed and direct debt together, however, the United States has still been showing much sharper increases in recent years than Canada.

Secretary Morgenthau - 5

At the present time, it is estimated that the Dominion direct and guaranteed debt amounts to slightly less than \$5 billions. On a per capita basis, this would be equivalent to about \$60 billions in the United States. This may be compared with the present Federal direct and guaranteed debt in the United States of less than \$48 billions.

In the case of provincial and municipal debt, Canada compares even more unfavorably with the United States. Total provincial, municipal, and local guaranteed debts in Canada amount to approximately \$3 billions. On a per capita basis, this would be equivalent to about \$36 billions in the United States, or almost double the aggregate State and local debt in the United States.

It should, of course, be remembered that comparisons of the public debt in different countries are subject to many qualifications. The relationship of interest charges to national income and the amount of and character of assets available for offset against the debt are particularly important.

#### Relationship between short- and long-term yields

All Canadian Government securities are higher in yield than United States securities of comparable term (Chart III). The curve expressing the relationship between yield and term, moreover, is much sharper in the case of Canadian securities than for United States securities. Consequently, the Canadian curve flattens out much sooner than the United States curve. As the chart shows, the yield on Canadian issues with a term of eight years is approximately as high as on those with a longer term. This represents a flattening of the curve approximately ten years sooner than takes place in the case of the United States curve.

For a term of approximately nine years or less, the yield on Canadian issues is at least double that on United States issues; and in the case of the shortest maturities, the difference is far greater. The yield on a Canadian issue of October 1943-45, for example, was 2.32 percent on January 13, as compared with a yield of .55 percent for a United States issue with the same call and maturity dates. (Both issues are selling at a premium, and are therefore figured to the call date.)

Although not as striking as this, the differences are also very large in the case of longer terms. A Canadian issue due in June 1958, for example, yields about 3.25 percent, as compared with 2.30 percent for a comparable American issue.

It should perhaps be observed that Canadian Government securities do not possess any right of exemption from income taxes. The interest on United States Treasury bonds, of course, is exempt from the normal income tax of the Federal Government and from State income taxes. This difference in tax treatment, however, accounts for only a very small part of the yield difference between Canadian and United States Government securities.

#### Ninety-day bills

The average rate on the last issue (due April 15) of Canadian 90-day Treasury bills was .78 percent. While this compares very unfavorably with the rate in the United States, which was negative again last week, it is much lower than the rate in Great Britain, which is still 1.11 percent in spite of the steady reductions which have been taking place recently. The rate on Canadian bills increased with the outbreak of war, but, compared with the increase in Britain, the Canadian rise was negligible. At the present time, the Canadian rate is about midway between the pre-war level and the war period high in September.

#### Recent trend in long-term bonds

Chart V compares, beginning with July 1938, the movement of long-term United States Treasury bonds and that of Canadian 3-1/4's of 1956-66, an issue which is payable only in Canadian funds.

The two series behaved about the same during 1938 except that the Canadian issue lost slightly more at the time of the Munich crisis. In 1939, the upward movement of United States Treasury bonds, which reached its peak in June, was not matched by the Canadian issue, which remained relatively stable until August. As a result, the yield differential between the two series became approximately half as large again by early summer as it had been at the beginning of the year.

In the crash which accompanied the outbreak of war, the Canadian issue did better than long-term United States Treasury bonds. Official support was given the market in both countries, however, so the decline was artificially impeded in both cases.

Since the September low point, the Canadian bond has recovered only about one-third of its war-crisis loss, and the yield differential, as compared with long-term Treasury bonds, has been reaching new high levels. At the present time, the differential is approximately double what it was a year ago.

Secretary Morgenthau - 7

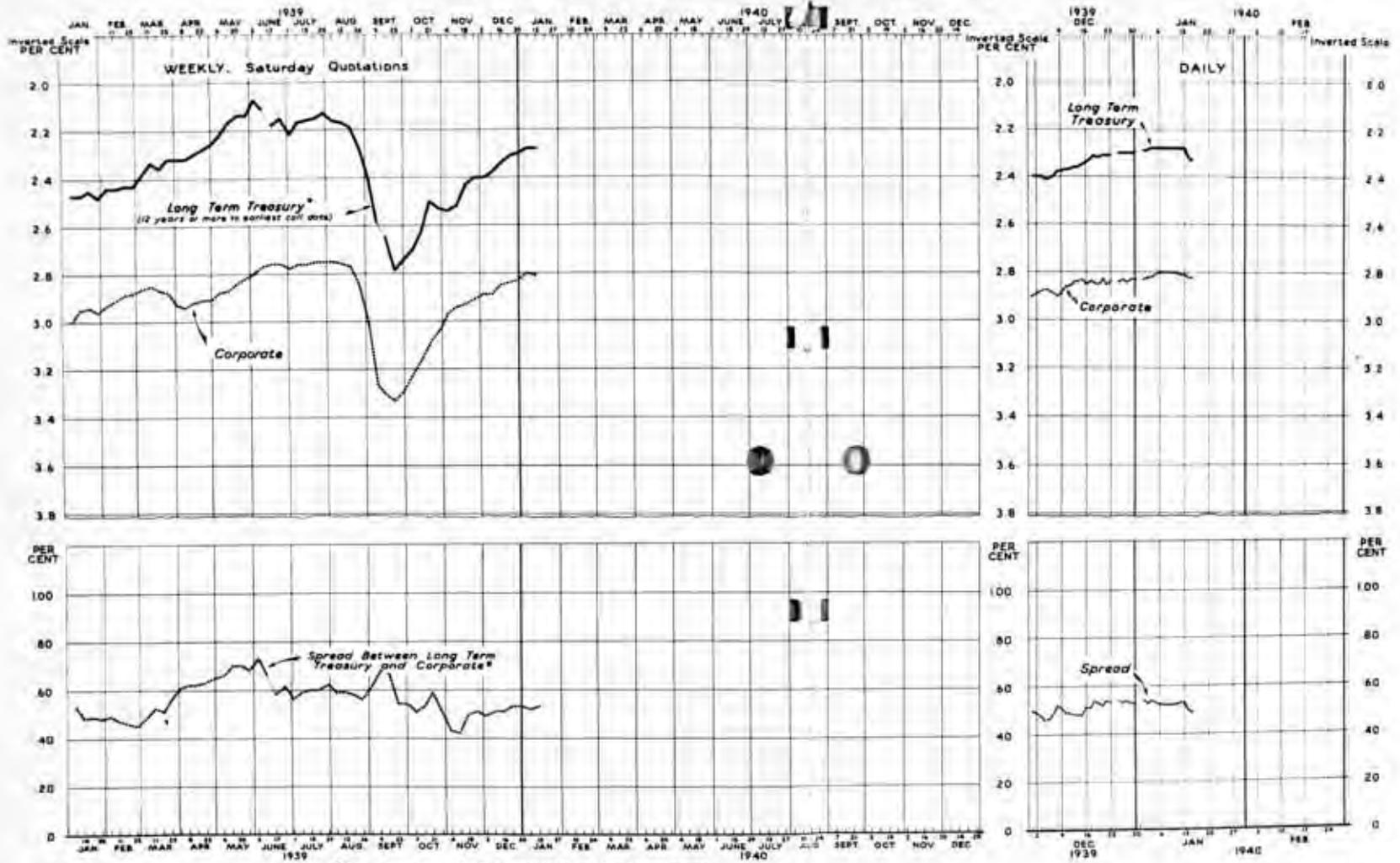
#### IV. British and French Government Securities

The British gilt-edged market, which was buoyant last week, took a sharp drop on Monday, January 15, when 2-1/2 percent consols fell 1-1/8 points (Chart VI). After a recovery of 1/8 on Tuesday, the price stood at  $70\frac{3}{8}$ , to yield 3.57 percent, as compared with  $71\frac{1}{4}$ , yielding 3.52 percent, a week ago (January 9).

French 3 percent rentes, which have been declining for the past two weeks, fell 1.05 points on Monday, January 15, and a further .60 points on Tuesday. At the close on Tuesday, rentes stood at 73.70, to yield 4.07 percent, as compared with 75.90, yielding 3.95 percent, on January 9.

Attachments.

Chart I  
 COMPARATIVE YIELDS OF AVERAGE OF LONG TERM U.S. TREASURY  
 AND AVERAGE OF HIGH GRADE CORPORATE BONDS

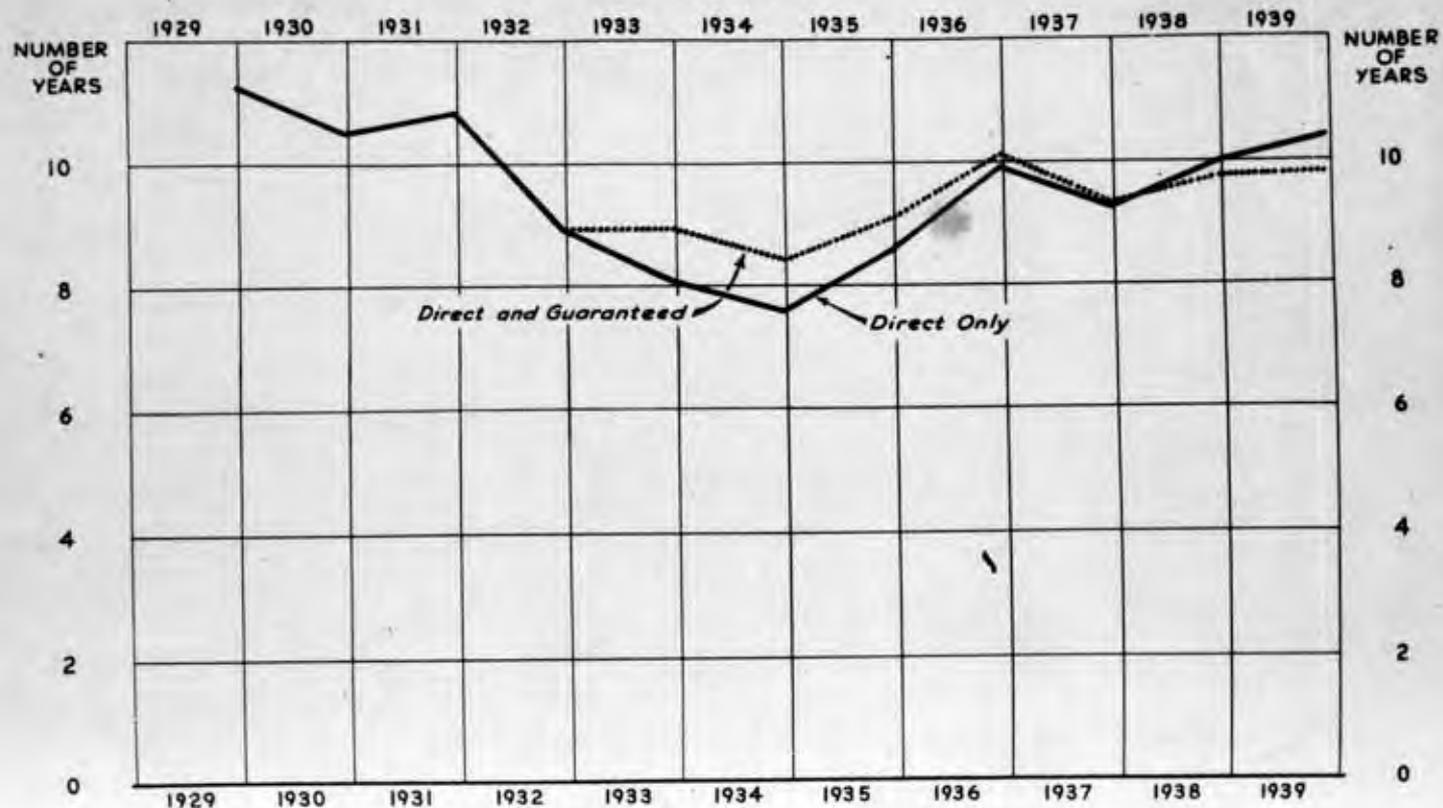


Office of the Secretary of the Treasury  
 Division of Research and Statistics

\*Based in line indicates change in comparison of long term Treasury average.

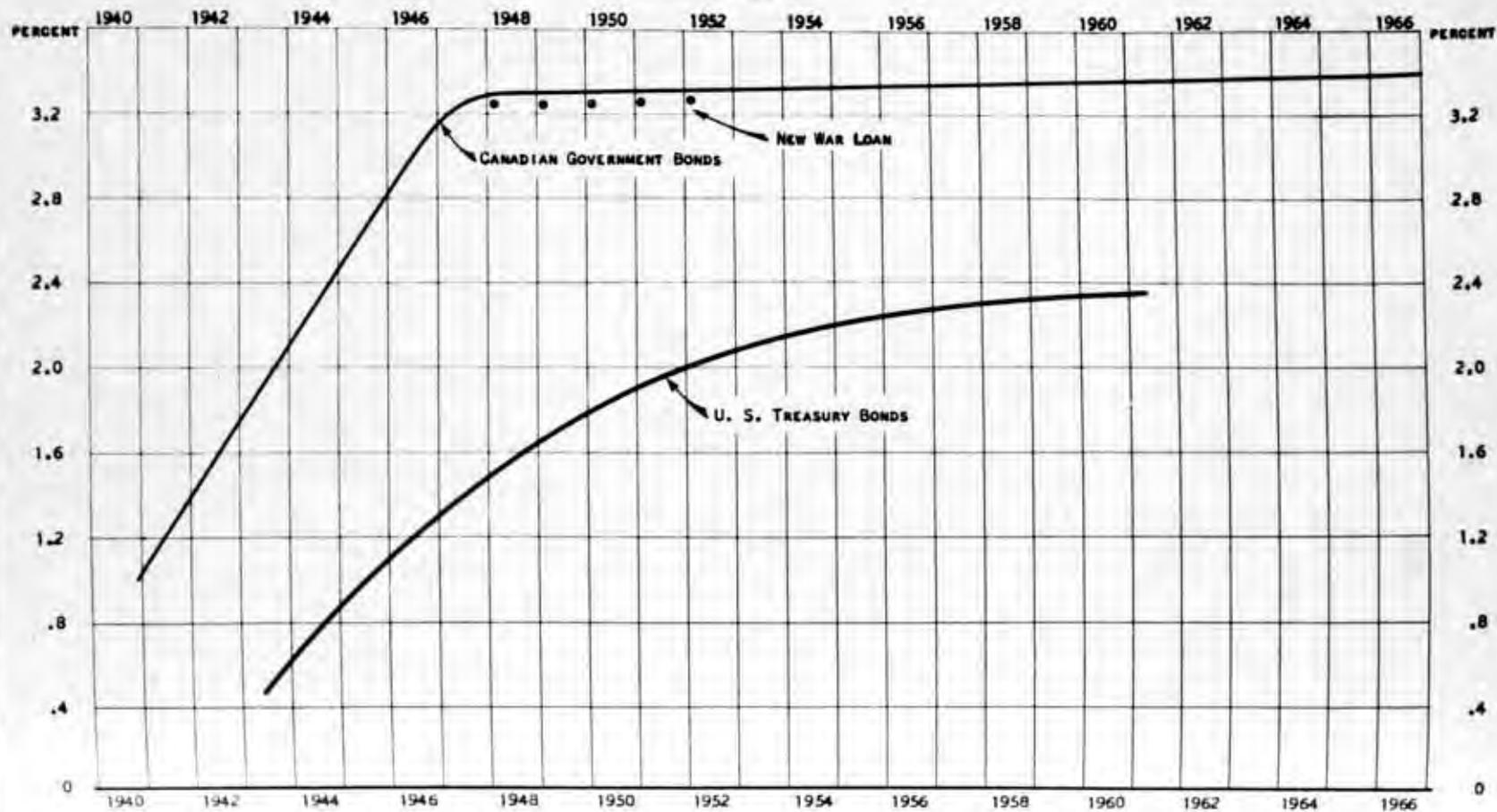
## AVERAGE LENGTH OF MATURITY OF INTEREST-BEARING PUBLIC DEBT

As of End of Year



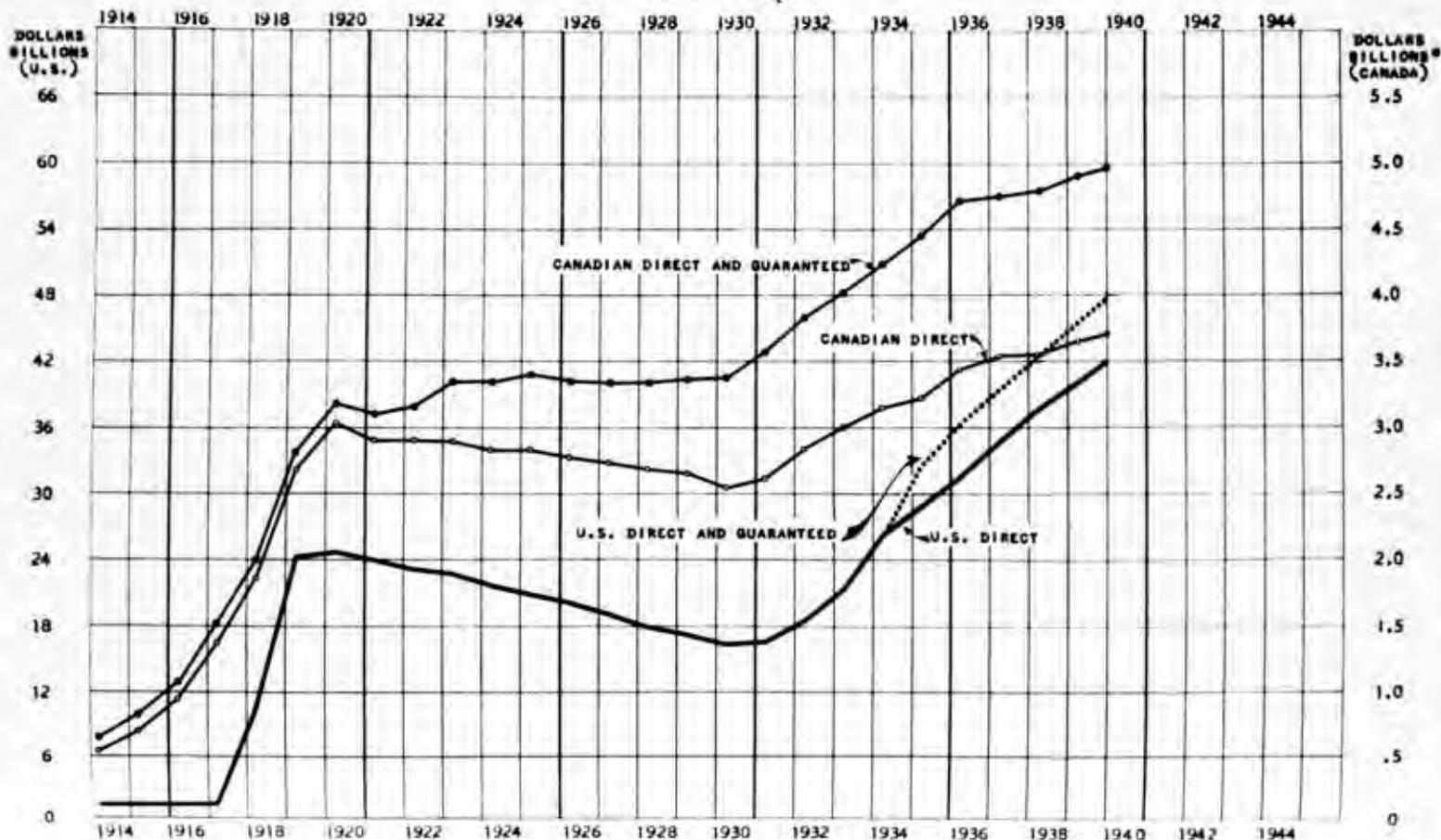
*Note: Exclusive of Consols, Postal Savings Bonds, U.S. Savings Bonds, Adjusted Service Bonds and special issues to Government agencies and trust funds*

Chart III  
 COMPARATIVE YIELDS OF U.S. GOVERNMENT AND CANADIAN GOVERNMENT SECURITIES  
 January 13, 1960



COMPARISON OF DIRECT AND GUARANTEED FEDERAL DEBT  
IN UNITED STATES AND CANADA

1914 - 1939

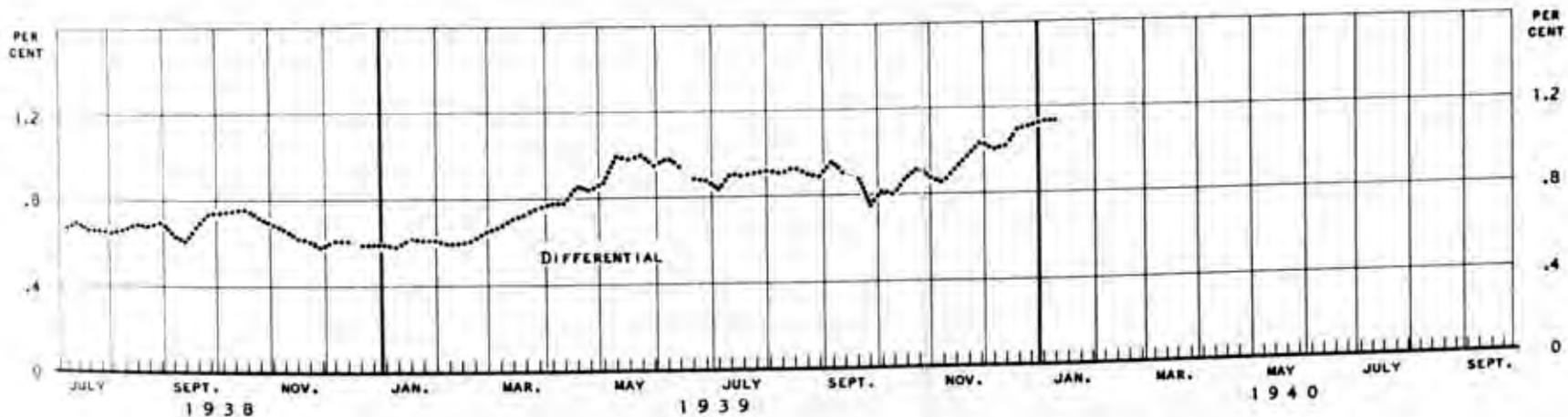
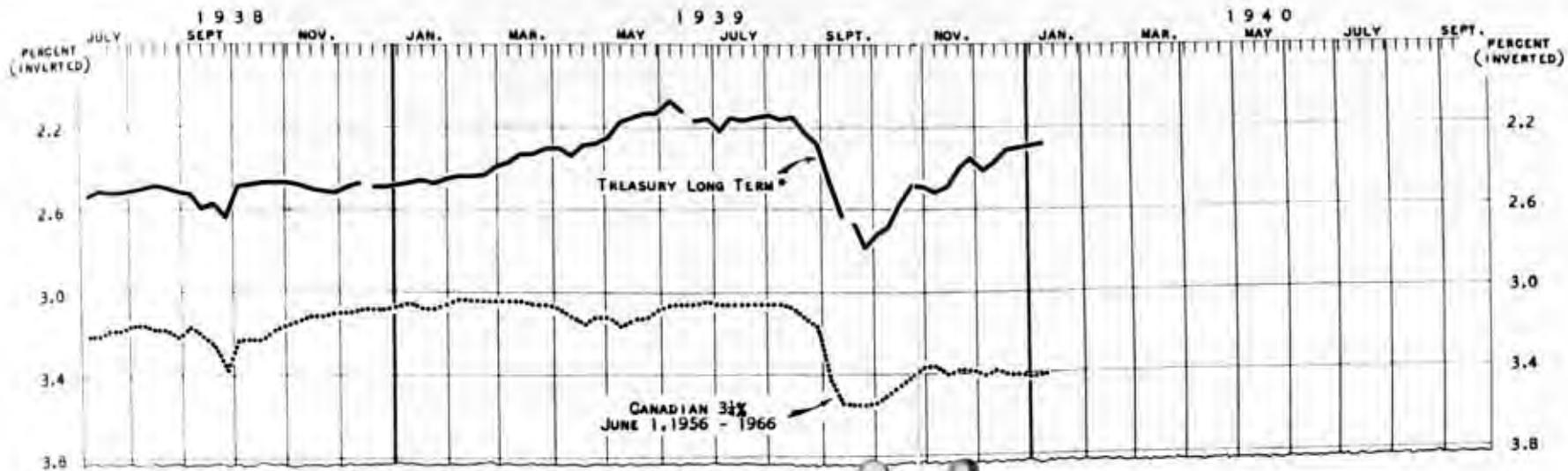


NOTE: THE FIGURES ARE AS OF MARCH 31, EXCEPT THE LAST PLOTTINGS WHICH ARE AS OF DECEMBER 31, 1939, AND WHICH ARE ESTIMATED FOR CANADA.

\*THE CANADIAN SCALE HAS BEEN ENLARGED 12 TIMES TO CORRECT FOR DIFFERENCE IN POPULATION

Chart V

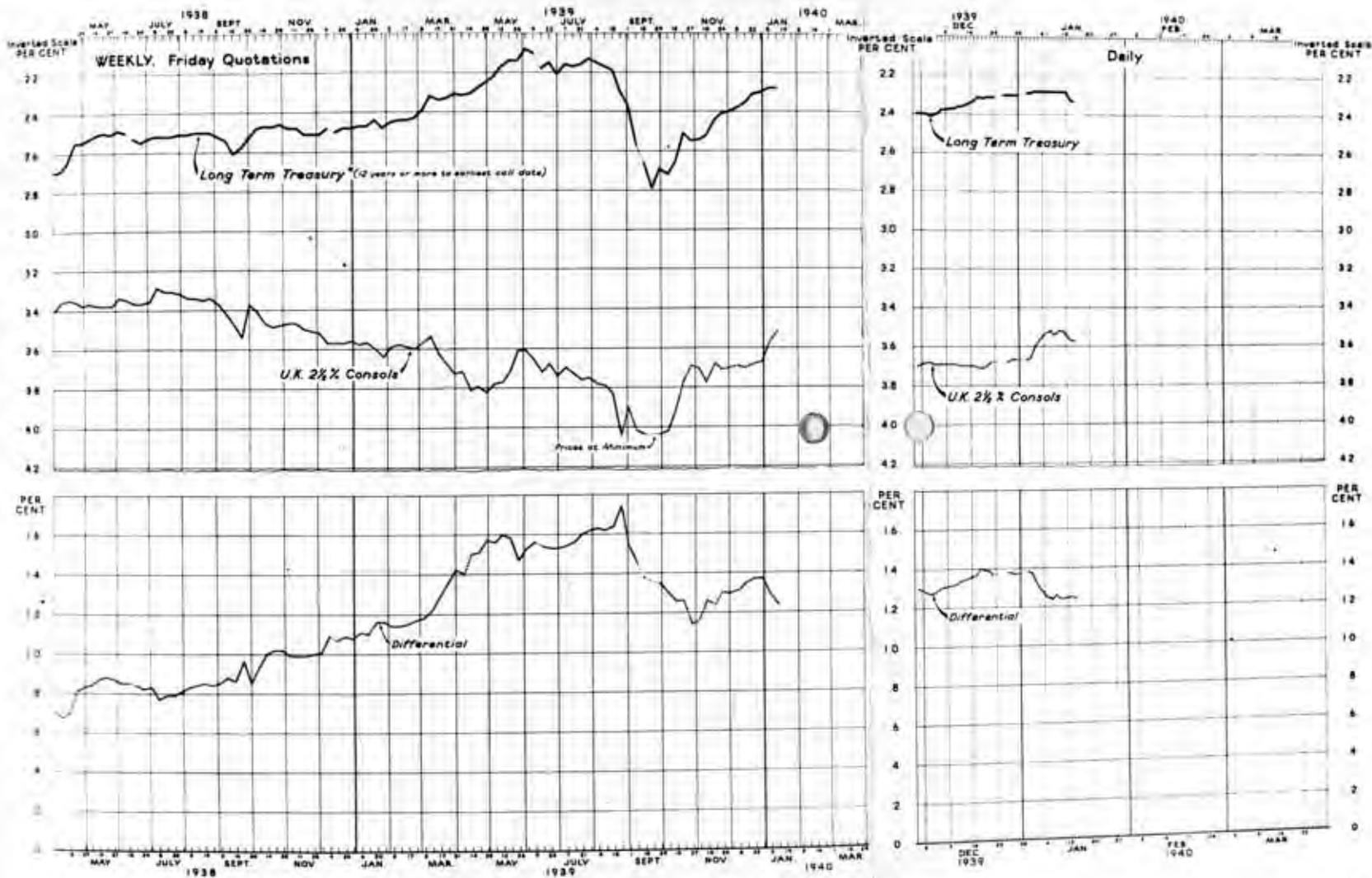
COMPARATIVE YIELDS OF AVERAGE OF ALL LONG TERM U.S. TREASURY BONDS  
AND CANADIAN GOVERNMENT 3½% BONDS OF 1956-'66



\* BREAK IN LINE INDICATES CHANGE IN COMPOSITION OF LONG TERM TREASURY AVERAGE

Chart VI

COMPARATIVE YIELDS OF AVERAGE OF ALL LONG TERM U.S. TREASURY BONDS AND U.K. 2½% CONSOLS



\*Break in line indicates change in composition of Long Term Treasury average

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE January 17, 1940

TO Secretary Morgenthau

FROM Mr. Cochran

CONFIDENTIAL

The foreign exchange market was quiet again today, and the rate for sterling continued its downward movement. Both commercial concerns and foreign banks appeared as sellers of sterling on balance. After opening at 3.96-3/8, sterling declined steadily to a low of 3.95-3/8 at the close.

Sales of spot sterling by the four reporting banks and the Federal Reserve Bank of New York totaled £561,000, from the following sources:

By commercial concerns.....	£ 226,000
By foreign banks (Europe, Far East and South America)....	£ 235,000
By the Federal Reserve Bank of New York (for Yugoslavia).....	£ 100,000
Total.....	£ 561,000

Purchases of spot sterling amounted to £317,000, as indicated below:

By commercial concerns.....	£ 171,000
By foreign banks (Far East and Europe).....	£ 146,000
Total.....	£ 317,000

The following reporting banks sold cotton bills totaling £42,000 to the British Control at the official rate of 4.02-1/2:

£ 25,000 by the National City Bank
15,000 by the Guaranty Trust Company
2,000 by the Chase National Bank
<u>£ 42,000 Total</u>

The rate for the guilder, after fluctuating within a narrow range most of the day, receded to a low of .5312-1/2 in the late afternoon. This decline resulted from the appearance, in a thin market, of an order to sell 200,000 guilders which the Irving Trust Company received from a bank in Amsterdam. The guilder closed at .5313.

The other important currencies closed as follows:

French francs	.0224-1/8
Swiss francs	.2242-1/2
Belgas	.1683
Canadian dollars	11-15/16% discount

There were no gold transactions consummated by us today.

The Federal Reserve Bank of New York reported to us the following shipments of gold:

\$3,431,000 from the Netherlands, shipped by the Netherlands Bank to the Federal Reserve Bank of New York, to be earmarked for account of the Netherlands Bank.  
2,741,000 from South Africa, shipped by the South African Reserve Bank to the Federal Reserve Bank of New York, to be earmarked for account of the Netherlands Bank.  
2,630,000 from Canada, shipped by the Bank of Canada, Montreal, to the Federal Reserve Bank of New York, for sale to the U. S. Assay Office.  
\$8,802,000 Total

The London spot and forward prices for silver were both fixed at 22-5/8d, a rise of 7/16d on some small Indian buying. The U. S. equivalents were 40.34¢ and 40.14¢.

Hendy and Harman's and the Treasury's prices for foreign silver were unchanged at 34-3/4¢ and 35¢ respectively.

We made seven purchases of silver totaling 550,000 ounces under the Silver Purchase Act. Of this amount, 300,000 ounces represented sales from inventory by two of the refining companies, and the remaining 250,000 ounces consisted of new production silver from foreign countries purchased for forward delivery.



CONFIDENTIAL

January 17, 1940  
1:15 p.m.

Secretary Hull called me at the suggestion of the President to say that the British had approached him yesterday to say that they wished to inform this Government that the Finns were thinking of taking the \$10,000,000 which they were getting from the Export-Import Bank to buy agricultural products in the United States, ship it to England, sell it to the English; the English would give them money and with this money the Finns would buy ammunition in the United States. Mr. Hull told the English that he thought it would have been an impertinence for them to tell us about this deal.

If the Finns, on the other hand, wanted to ship American agricultural products to England with the \$10,000,000 they got from the Export-Import Bank and sell it to the English, and with the money they received from the English buy ammunition with it in England, Mr. Hull gave me the impression he thought that would be all right. Personally, I can't see that there is a great deal of difference between either proposal.

I asked Mr. Hull why he was letting me know and he said he was because the President asked him to. I told him neither the Finns nor the English had approached me on this matter.

Mr. Hull then went out of his way to say that he knew that when the President wrote a letter to Congress on lending money to Finland that he would get just the kind of reception that he did get. I still don't know why Mr. Hull called me but I will try to find out from the President.

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1:15 p.m.

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Mr. Hull said that the President asked him to call me and tell me about the above.

## PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Berlin, Germany  
via Rome

DATE: January 17, 1940; rec'd January 21.

NO.: 134

CONFIDENTIAL.

Reference is made to telegrams No. 12 of January 3 and No. 38 of January 6 from the Embassy.

According to information available, there has been delay in the announcement of the new war financing measures which had been expected shortly after the first of the year because of alleged differences within the Government as to the best ways and means for absorbing several billion reichsmarks of excess purchasing power of its nationals. On good authority it is reported that at present the Finance Ministry has under consideration five different plans for financing; some of these plans emphasize better utilization of savings and stimulation thereof, while drastic tax increases are suggested in others. Plans for institution of compulsory saving are reportedly meeting with serious criticism, indicating that there seems to have been a certain shift in government expert opinion.

The leader of this opposition is reported to be Dr. Heintze, who is the President of the German Savings Banks Association. It is said that this compulsory saving is objected to on the ground that it will jeopardize voluntary saving, particularly as restriction on withdrawals of old voluntary savings deposits may be necessary. Heintze,

- 2 -

according to this information, therefore has submitted his own plan; under this they would stimulate savings by tax privileges, and persons would fall in a lower taxation group if they undertook to save a specified part of their income; Heintze suggests that savings available for investment in bonds of the Government would more than offset any loss in direct tax revenues which the plan might cause. Another plan it is reported he made is to make savings more attractive by introducing savings certificates with a low interest rate but with premiums allotted by drawings; this policy would amount to a lottery loan in practice.

Dr. Ley and the Labor Front are reported to sponsor another plan, under which a certain part of wages and salaries should be paid in savings certificates or scrip, which would be credited toward higher old age pensions later on.

Further reports are that the Finance Ministry is considering other plans which propose to increase to 50% of <sup>profits</sup> or even 60% the corporation income tax (which is 40% at present) and also to raise the war surtax on the personal income tax, which at present is 50%.

On the other hand it is alleged that the Government has abandoned for the time being the plan of a high turnover tax on sales of non-rationed goods of 20 or 25% because the Reich Price Commissioner objected, pointing out that

if

if this plan were adopted, it would be difficult to maintain the existing wage and price level.

Available information is to the effect that among Government financial experts there seems to be a consensus of opinion that the present situation can hardly be met by tax increases alone; it is believed that the decision which is likely to be taken shortly may be a compromise between the promoters of plans for encouraging saving which would not be based on open compulsion but rather on some method of indirect pressure, and those who advocate higher taxes.

It is requested that you inform the Treasury of the foregoing.

END OF MESSAGE.

KIRK.

TO THE PRESIDENT  
ALCOHOLIC BEVERAGE  
REVENUE DEPARTMENT  
WASHINGTON, D. C.  
MAY 11 1934

EA:LWW

215

FROM: MR. GASTON'S OFFICE

1-17-

TO: The Secretary

Mr. [unclear] called this afternoon to ask me to  
let [unclear] know that they (State Dept.) were ready  
to take up the matter of the Brazilian debt and  
[unclear] considered it urgent. I found later that he  
first called Harry White and was referred to me.  
If possible I will get him to come over here for a  
conference tomorrow with Harry, Joe and me on the  
matter of procedure and will use that occasion to  
clear up the crossed wires on the Colombian matter.  
I don't do it this afternoon because Joe and Harry  
have both gone over to a Pan-Am bank meeting.



## PARAPHRASE OF TELEGRAM RECEIVED

FROM: American Embassy, Rio de Janeiro

NO.: 27

DATE: January 17, 1940

Reference is made to my no. 16 of January 13, 1940, noon.

I am told by Aranha that yesterday he and President Vargas talked over the debt situation and that the latter agreed to a provisional arrangement whereby payments would be resumed under the Aranha plan on the following basis: 50 percent of all dollar payments due the first year under the Aranha plan with larger payments in subsequent years as set forth in the Aranha plan. I called to his attention that when we had talked the other day he had mentioned only 50 percent of all dollar payments which would be due in the final year of the Aranha plan. Aranha said that there was not such a very great difference between the two years; however, he added, "Anyway, you make a reply and give me your opinion and I will try to get President Vargas to accept 1937 as the base year for beginning payments."

Aranha stated that a meeting of the cabinet will be held Thursday afternoon, January 18, for the purpose of considering this debt question.

Aranha

-2-

Aranha is leaving early Friday morning by plane to go to Buenos Aires.

I shall appreciate it if you will let me know what the Department's attitude is.

CAFFERY

EA:EB

TO THE DIRECTOR  
PROPERTY CONTROL  
JAN 2 1948  
RECEIVED



OFFICE OF  
COMMISSIONER OF INTERNAL REVENUE

TREASURY DEPARTMENT  
WASHINGTON

218

*Remond*

January 17, 1940.

*Jan. 31/40*

*(meeting in 2-6-40  
Hep's office to  
consider this)*

MEMORANDUM FOR THE SECRETARY:

In compliance with your request to Mr. Foley, I conferred yesterday afternoon with Messrs. Foley and Irey regarding the proposal to secure a court order in the Indiana matter to compel testimony from Bowman Elder, former treasurer of the Hoosier Democratic Club (Two Per Cent Club).

Messrs. Graves, Sullivan, and Wenchel were also present.

You will recall that substantial sums of money have been traced to Elder, as treasurer of the Two Per Cent Club, including certain amounts paid to him by beer and liquor dealers licensed by the State of Indiana, and that he has not satisfactorily accounted for the disbursement of these sums.

Mr. Foley expressed it as his opinion that it would be premature at this time to secure the proposed court order. He felt that if after such an order, which would be a matter of public record, the investigation should develop nothing warranting prosecution of the persons involved, there would be danger that the public might gain the impression that the Department "had been called off" from the investigation.

Mr. Irey favored action to secure the order immediately. His view was that the public is already fully aware that the investigation is proceeding, and that, in fact, it is believed by the persons involved in Indiana that the Department has now changed its mind about attempting to compel Elder to testify. It was his opinion, accordingly, that there would be little danger in asking for the court order at this time. He correctly pointed out that without such an order there will unavoidably be much delay in completing the investigation.

Mr. Foley called attention to the fact that evidence has been discovered by our investigators appearing to connect the Kentucky Rock Asphalt Company of Louisville, Ky., with improper payments to Elder as treasurer of the Two Per Cent Club. He suggested that steps to secure a court order against Elder should be postponed pending further investigation of the transactions involving this company, his opinion being that with evidence available of payments to Elder from a corporation outside the State of Indiana the Department would be on stronger ground in seeking the proposed order.

-2-

Although not agreeing with Mr. Foley that the Department could incur any important risk in proceeding immediately to secure a court order against Elder, I do not see any objection to delaying briefly to permit the further exploration of the Kentucky Rock Asphalt Company matter. Instructions have accordingly been given to the investigators to concentrate for the present on this phase of the investigation, and to develop, if possible, evidence connecting the Kentucky Company with payments to Elder. Mr. Foley has given similar instructions to the attorneys whom he has assigned to the case.

My opinion is, however, that whether or not such evidence is forthcoming, we should not delay much longer in asking for a court order to compel testimony from Elder. As the matter now appears, I doubt the wisdom of postponing this beyond a period of ten days.

By way of explanation, I might add that a court order of the kind referred to above is a device not infrequently resorted to in the investigation of tax-fraud cases to compel testimony from reluctant and uncooperative witnesses. Such an order does not necessarily imply any guilt on the part of the persons under investigation, but is merely a means of securing information not otherwise available to permit a determination by the Bureau whether there has been fraud upon the revenues.

  
Commissioner.

January 17, 1940.

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(Signed) Guy T. Helvering

Commissioner.

## TREASURY DEPARTMENT

## INTER OFFICE COMMUNICATION

DATE January 18, 1940

TO

Secretary Morgenthau

FROM

Joseph P. Cotton, Jr.

Re: Export-Import Bank meeting,  
January 18, re Finnish Credit,  
and discussion of Scandinavian  
Loans.

Mr. Jones called a meeting to recommend to the Executive Committee that the Bank assume, in addition to the \$3 millions already assumed, the balance of the existing \$10 millions Finnish commitment, namely \$7 millions which it was originally agreed that the RFC would undertake. He pointed out that the Finns do not want to buy agricultural products and said that the RFC had no power to finance the export of other than agricultural products. He had hoped to be able to secure additional capital for the Bank from Congress before the Finns needed to use more than \$3 millions, but the question of increasing the Bank's capital has become snarled up with the Finnish loan in Congress.

Mr. Feis questioned whether assumption of this additional commitment would be justified in view of the \$100 millions statutory limitation on the aggregate of loans which the Bank may have outstanding at any one time. Mr. Jones said he would assume personal responsibility that the assumption of the commitment was justified on the basis of the present financial condition of the Bank. Feis raised a second point — that he had instructions from Mr. Hull to insist, as a condition of the commitment, that use of the credit should be limited not only to the purchase for export of non-military goods, but that such goods could not be sold by the Finns in other countries. Mr. Jones said he was very much against the latter condition and, at Feis' suggestion, said he would iron it out with Mr. Hull. He said that this country could not police what happened after the goods were exported.

The Committee approved, in principle, a resolution to be drafted to assume the above commitment, the State Department to be registered as voting in favor if Mr. Hull's approval could be secured.

Mr. Jones went on to discuss the Finnish and Scandinavian situation generally. He said that he had told the Congressional committees considering the Finnish loan that the executive had been willing to take the

- 2 -

responsibility to make available an Export-Import Bank credit while Congress was not in session, but that now it was up to Congress and that, even if funds were made available for the Export-Import Bank, no further loan would be made to Finland unless Congress specifically acted in the matter. He said there was no criticism in Congress of the \$10 millions credit made available. His idea with regard to the Bank is that Congress should authorize the RFC to advance money to the Bank to create a revolving fund. He said that he could have put this across a couple of weeks ago but that it had become snarled up with the Finnish loan. His idea was that both the matter of additional capital for the Bank and the Finnish loan problem should be allowed to cool off for a while and he questioned very much whether it would be advisable for Secretary Hull to appear before Congressional Committees in support of the Finnish loan at this time.

I asked him about the reported possibility of credits to Norway and Sweden. He said that he had told them that, in so far as agricultural commodities were involved, the RFC would be prepared to make available \$10 millions to each any time they wanted it.

f.p. eh.

Treasury Department  
Division of Monetary Research

224

Date..... January 18, 1940. .... 19

To: Secretary Morgenthau

Appended is a report, prepared by Mr. Eddy of the Division of Monetary Research, on Lord Beaverbrook's article on Gold and War Debts which you requested. Mr. Eddy's comments are somewhat more generous to Lord Beaverbrook's views than they merit, but even so they indicate Lord Beaverbrook has considerably distorted the facts of the situation.

*House*

MR. WHITE  
Branch 2058 - Room 208

# TREASURY DEPARTMENT

225

## INTER OFFICE COMMUNICATION

DATE January 17, 1940

TO Mr. White

FROM W. A. Eddy

Subject: Lord Beaverbrook's Article on Gold and War Debts

Lord Beaverbrook's article made the following points:

1. He says he wants to tell the "true" story of the war debts, the failure of their attempted payment, etc., in order to modify criticism on the conduct of England's policy.
2. He claims that neither the British nor the Americans believed that this country would seek repayment of the war debts. When Mr. Mellon was the first request for a settlement in 1922, it came as a surprise.
3. The Baldwin-Mellon agreement (1923) was forced upon the ill and feeble-minded, Bonar Law, despite the Premier's own previous instructions and the warnings of Winston Churchill, Ronald McKenna, J. M. Keynes, and Lord Beaverbrook.
4. Maintaining payments under the agreement bankrupted the British Treasury and drained England of 2 billion gold dollars. The United States had agreed neither British goods nor British-owned American securities, but would only pay in gold, which was soon exhausted. The debt agreement therefore led inevitably to Britain's being forced out of gold.
5. America's financial crisis, on the other hand, did not force a payment of gold, since we still had 24 billion of gold.
6. British holders of American gold bonds and of gold located in America were required to take depreciated paper dollars. This repudiated 25 percent of America's debt in the hands of the British.
7. Since 1933 Britain has had to devote all her powers to rearming.

### Summary Comment

The point in Lord Beaverbrook's article which seems to have most validity is that there was a problem in international payments which was temporarily solved during the 1920's (by American loans to Germany,

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Although the article does not bring this out). His points that no repayment was ever intended, that the settlement was rather forced, and that payments drained England of gold are all untrue, while his contention that she could not resume full payments in 1933 and after is debatable. His comments on his separate points follow:

1. Lord Beaverbrook's desire to allow criticism is natural. Nevertheless, however sincerely he believes it, his "true" story of war debt developments may be called either a misrepresentation or a grossly biased account.
2. Although some speeches were made favoring giving money or supplies to the Allies, the official attitude did not contemplate anything except loans and bills loans. The correspondence with foreign representatives pertaining to the original loans recognizes this; interest was paid (out of the loans) up to 1919, and there is much other evidence that repayment was expected.

In 1919 the Treasury declared a three-year moratorium on war-debt payments on foreign exchange (but not on accruing interest charges). At the same time Congress established a committee to handle the debts, and the Treasury sent notices of amounts due. Except for the last step, the moratorium seems to have slipped Lord Beaverbrook's mind.

3. Not all some people thought the war debt agreements impossible to fulfill, undoubtedly true. The same or other people gave similar arguments about the reparations which the Allies were compelling Germany to pay. Whether there was any special circumstance which forced the British Government to make a commitment against its better judgment is hard to ascertain, though it seems doubtful. Terms negotiated by the British, then Chancellor of the Exchequer, and Montagu Norman, with the Germans for discussion with the rest of the Government, would seem to constitute fair conditions.

4. The suggestion that the war debt payments stripped England of her gold ignores the facts of the case. England's gold stock showed no decline from its 1920-24 level to 1930. On June 30, 1931, after the last war debt payment before going off gold, it was as high as it was at any previous time except temporarily in 1926. Even had there been no debt payments, it is by no means sure that England would have accumulated a larger gold reserve.

No mention is made of the fact that in the late 1920's England was receiving from the Central Powers and her Allies slightly more than she had to pay the United States. In the entire 1924-31 period, including the earlier years before full payments were being received from the Central Powers and Allies, England paid the United States only one quarter of a billion dollars more than she received.

The United States gold stock, at the same time, showed no net change from 1924 to 1930. Thus, the assertion that England shipped us \$2 billion of her gold in those years was simply not true. (Incidentally Lord Leaverbrook overstates the amount paid the Treasury, by including a half billion of interest "paid" by borrowing more and now lapsed into default.)

England's debt payment of \$160 million a year to the United States was only one item — and a comparatively small item at that — in her balance of international payments. Any serious analysis of England's international economic position during 1924-31 would have to take into account the over-valuation of the pound in the return to gold in 1925, the loss of England's export markets resulting partly from the over-valuation of sterling, her excessive foreign lending, including funds sent to this country to buy securities and make call loans, her deflationary financial policy at home, and many other factors.

America balanced up its international payments without large gold imports in the 1920's by making billions of dollars of foreign loans. Many of the loans were to Germany, thereby in effect financing her reparation payments to the Allies. Since many of the foreign loans are now in default, the loss has fallen on American citizens.

The idea that America declined to take securities as payment of the debt seems made up out of whole cloth. United States Government securities were and are tenderable as full settlement of the debt. Other securities could have been liquidated for dollars readily enough up to 1929. Either before or after 1929 it seems out of the question that England was willing to compel surrender of private investors' American securities.

5. It is true that the British gold stock was reduced from about \$500 million, the average post war level, to \$590 million, in the flight of capital following the Austrian and German collapses in the Summer of 1931. (It should be remembered that there used to be less than \$175 million in the Bank of England before the War. The traditional policy always was to rely upon bank rate and other monetary controls, and not upon a large gold reserve.) Whether the British were really forced to abandon gold is a matter of controversy among English economists.

Resumption of war debt payments after the Hoover Moratorium expired in 1932 would have been a burden on the British budget since reparation payments had practically ceased, and would have tended to reverse accumulation of gold. England's refusal, however, to continue full war debt payments beyond 1932 or any payments at all beyond 1933 can

hardly be based on a lack of gold. By June 1933 she had \$922 million of gold, a much larger reserve than ever before. The scheduled annual payment to the United States was \$160,000,000. By December 1934 she had \$1.5 billion of gold and by 1937, \$4 billion — a many fold greater total than she ever had before. If there had been serious concern in England over any lack of gold it might well have taken the form of restrictions on capital outflows such as sent several hundred million dollars to this country during the last six years for the acquisition of securities and deposit balances. Such concern has not been shown.

The argument (point 7) that after 1933 she had to conserve all her gold for war raises this question: if the fear of war was responsible for the refusal in 1933 to pay the war debt, why were not armament expenditures increased materially until 1936? The alleged "preparation" for war seems to have been at first largely at the expense of the United States Treasury. The truth of the matter appears to be that the Allies were unwilling to tax or borrow to pay war debts once German payments had stopped. Both France and England had enough gold if they wanted to use it, however little good the gold would have done us. Or either could have resorted to foreign exchange control to reduce the amount of capital going here to go into securities and dollar balances.

6. The injury to British holders of American bonds or gold is greatly exaggerated. The profit to holders of dollar assets, arising from the temporary depreciation of the pound, was terminated by a correction of the position of the dollar. To assume that we ought not to correct the position of the dollar for fear of depriving foreign investors of a windfall profit is indeed strange reasoning. Since the dollar-pound rate averaged \$5.04 in 1934, dollar assets bought at the parity showed a 4 percent loss on exchange, measured from the former parity, rather than the 40 percent he suggests. Dollar assets held till 1938 would have showed a gain over the former \$4.86 rate.

7. This point has been discussed under 5.

January 18, 1940

To: The Secretary

From: Mr. Young

Re: Cudahy Packing Company Case.

In accordance with your instructions, Mr. Harold Graves advised me that Commissioner Helvering would submit a complete report to you covering those tax cases which were left open or in an indefinite state at the time of Mr. Hanes' resignation.

You will recall that I mentioned the Cudahy Packing Company case last Monday and that you asked me to submit a summary thereof. Despite the fact that Commissioner Helvering under the present arrangement will undoubtedly submit a report on this case, I would like to add a comment as to what happened in November which was the last time that the matter came up for consideration in the Office of the Under Secretary.

Between November 15 and November 23, 1939, attempts were made by Mr. William H. Taylor, Counsel for Cudahy in Boston, and Mr. Paul Shorb, of the firm of Covington, Burling, Rublee, Acheson & Shorb, probably acting under the instructions of Mr. Thomas Creigh, General Attorney for the Cudahy Packing Company in Chicago, to reopen settlement negotiations.

Last April an extraordinary conference, at which I was present, was held under the auspices of the Under Secretary with representatives of both the Bureau and Cudahy for the purpose of working out a compromise figure for the settlement of the case. It was agreed at that time by all parties that if such a figure were not agreed upon the case would have to be settled in the courts. No such figure was agreed upon and the Bureau proceeded to issue its deficiency notices in the regular routine fashion.

Between April and November nothing had occurred to alter the position of the Commissioner in this matter. The efforts of Cudahy to reopen negotiations in November represented a

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deliberate attempt to secure the intervention of Mr. Hanes and to have him upset the position of the Commissioner if possible.

After consultation with Mr. Hanes, I talked with Messrs. Shorb and Taylor and informed them that the Commissioner would continue to receive the complete and whole-hearted support of the Under Secretary.

Although this unwarranted attempt to reopen negotiations failed, and despite the fact that the extraordinary conference last April was designed to end the long drawn-out negotiations which had taken place previously, it is my feeling that Gudahy will make some further attempt to complicate this already complex situation either by an appeal to you, to Under Secretary Bell, or some other responsible official.

*Ry.*

(COPY:FE:EJW)

Air Mail

No. 45

AMERICAN CONSULATE GENERAL  
American Foreign Service, Hanoi, Indochina,  
January 18, 1940.

Subject: Conversations with Mr. M. E. Sheahan  
regarding Transit to China.

The Honorable

The Secretary of State,  
Washington.

Sir:

I have the honor to refer to my despatch no. 41 of January 12, 1940, summarizing certain conversations with Mr. M. E. Sheahan, an American motor traffic expert, in regard to the situation at Haiphong and as to possible new routes of transportation to China via Indochina, and to report the information which he has made available since his return from inspecting the damage done to the Indochina-Yunnan Railway by the Japanese bombings.

Mr. Sheahan stressed the necessity of clearing the port of Haiphong of cargo urgently needed by the Chinese National Government. It would appear, from present indications, that the railway to Yunnan will be bombed again and accordingly the available capacity of the railway should be used now to its fullest capacity for essential cargo. Godowns are being built in Chinese territory, across from the Indochina frontier, and, insofar as possible, the essential cargo at Haiphong will be rushed by railway into Chinese territory.

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The railway has cooperated by establishing trans-shipment service at the two breaks in the line. A preliminary estimate was made that about 200 tons a day could be handled, mostly gasoline in tins, light machinery and spare parts, but I believe that this figure is much too high - perhaps about 100 tons are being transported daily. Heavier freight will be taken across the frontier by railway and will be stored in godowns until the railway is open or until the road to Mengtze and Kunming is open to motor traffic. This road is considered by Mr. Sheahan as being highly important, provided of course that the frontier is not closed as a result of Japanese pressure.

The Caobang road will also be used in clearing the cargo at Haiphong, not only freight but trucks. Unfortunately, the present condition of the road is such as to limit carrying capacity to a pay load of a little over 1 ton. Mr. Sheahan stated, in speaking of this road, that the Japanese have already bombed and machinegunned a number of sections and working parties. This does not promise well for the future of the road and other competent observers are not unduly optimistic as to this route of supply to the Chinese National Government.

Mr. Sheahan proposes that the port of Haiphong should be embargoed for the time being, until the congestion of cargo is

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cleared or until the question of the frontier is clarified. Such Chinese Government freight which is already en route to Haiphong should be diverted to Rangoon, and I am given to understand that at least some ships have been so diverted. In addition, as complete reliance cannot be placed on the future carrying capacity of the railway and the Caobang road, Mr. Sheahan agrees that at least some of the cargo at Haiphong should be transhipped to Rangoon. I have been informed that already a certain amount of gasoline in drums and some assembled trucks have been so transhipped.

The centering of authority in the Southwestern Transportation Company to handle all freight for the Chinese Government at Haiphong, as suggested by Mr. Sheahan, appears to be a logical move and should eliminate the hitherto existing division of authority. One step in this centralization has been taken - all Chinese Government departments are now under one roof. It is unfortunate that such centralization was not undertaken in the past, in purchasing as well as in receiving and forwarding of cargo.

In summary, although optimistic plans for transportation to China via Indochina are being formulated, no one can say categorically that such and such route will be feasible or successful. Consequently, many schemes are being considered and

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tried to assure the Chinese National Government of adequate supplies of essential commodities.

Respectfully yours,

For the Consul at Saigon,

CHARLES S. REED II,  
American Consul

Original and 2 copies to the Department  
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