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Draft used at 9 am meeting, May 15th,
in Secretary's office.

DRAFT OF TREASURY STATEMENT ON EXCESS PROFITS TAX

My purpose today is to discuss with you the problem of corporate taxation in the present emergency. What I shall have to say is supplementary to the statement made by Secretary Morgenthau when the current hearings were opened and to the suggestions laid before you subsequently on behalf of the Treasury Department.

The Treasury is called upon to meet expenditures greater than have ever been made in the nation's peacetime history, and probably greater than at any period in our history, in peace or war. At such a time we cannot expect to rely on normal sources of revenue or be content with revenue in normal amounts. We must adopt extraordinary measures to deal with our extraordinary situation.

Your Committee is now formulating changes in our tax system, both to provide the revenues needed to finance the defense expenditures that we are committed to make, and also to assist in maintaining the economic health of the nation. Our people know that great sacrifices must be made and they are prepared to make them. They rely upon us so to plan our

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financial program that, however severe its burdens may have to be, they will rest fairly and justly upon all individuals and all businesses.

The tax program which you will propose will necessarily consist of many elements. Any one tax, viewed by itself, may appear to be stringent. All must be viewed, however, as parts of a whole. This is an emergency. Taxes that would not be proposed in peace times are a necessity now. We cannot give effect to all those niceties of exemptions and saving classes that are appropriate to easier occasions but today will defeat our ends.

I have been asked particularly to discuss the excess profits tax, first enacted in the fall of 1940. Our experience with it is still limited, for many of the returns of the largest corporations have not yet been filed. Enough have been filed, however, to convince Treasury officials in charge of administration that important changes in the law must be made in the interests of fairness. We are collecting large sums by means of this tax, but the profits of a good many business firms are not being touched by the tax,

although these profits are excess profits by any reasonable standards. Here is certainly a place to broaden the base. Surely the skill of this Committee and its experts is adequate to the task of bringing within the tax the known cases of corporate excess profits.

I want first to outline the principles which I believe should govern the taxation of excess profits; second, to indicate respects in which the present law fails to accord with those principles; and third, to suggest possible remedies which the Congress may wish to consider.

I - Principles

Under present conditions some kinds of profits may be appropriately subjected to heavier taxation than other kinds. This may be necessary in order to distribute the burden fairly and to avoid unfavorable economic effects that might result if the revenue were raised in other ways.

1. Defense profits

The first type of profits which should, in a period of this kind, be subjected to special taxation comprises the profits which may be reasonably

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attributed to the defense program. Such profits are being made out of the sacrifices of the people as a whole and should be returned to the people in taxes, insofar as may be possible without destroying necessary incentives to produce defense goods.

In many cases it is not possible to distinguish with precision the additional profits due to the defense program. The effects of defense spending are diffused throughout the whole economic system. It is necessary, accordingly, to assume that in general, increases in profits during this period are due to defense. Inability to measure defense profits precisely should not discourage us from subjecting them to special taxation even at the risk of hitting some income not derived from the defense program.

2. Profits in excess of a necessary normal return on invested capital

The other kind of profit that can properly be subjected to special taxation comprises profits in excess of a necessary normal return on invested capital,

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even if this return was being earned in the years prior to the defense program. The existence of such profits, while often due primarily to good management, is in numerous cases due to monopoly, imperfect competition, or fortunate circumstances, and not to any outstanding service to the public. When the imperfections of our economic machine have permitted this to happen, it is equitable and desirable that the excess profits be subjected to special taxation. Furthermore, at a time when heavy taxes must be imposed they should be levied where they will assist best in maintaining a well-functioning economy. To take an especially large share of the profits in excess of a normal return on invested capital will not cause any companies to go into bankruptcy or withdraw from business.

I am aware that the anticipation of extraordinarily large profits may in many cases have put security prices well above a figure that would represent invested capital. The imposition of these special taxes may seem harsh to individuals who have purchased those

old - removed at 9 am
meeting 5/16 7

securities at such levels. We cannot entirely disregard this aspect of the problem, but we must remember that no legislation is ever passed and no progressive step is ever taken which does not disturb the established interests of some people. We submit that established expectations of high profits are entitled to no more protection than an individual's expectation of a continued large salary, now subject to a heavy tax. This is an emergency, and changes must be expected.

I am also aware that the application of the principle of taxing profits in excess of a necessary normal return on capital involves difficulties of both principle and technique. These difficulties should not be underestimated, but I feel sure that we should not allow them to stand in the way of our seeking to attain the main objective.

II - Defects of the present law

In the light of the principles just stated, let us now examine the excess profits tax law passed last year, to see in what respects, if any, it fails to correspond to them.

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1. Failure to reach large parts of defense profits

The Excess Profits Tax Act of 1940 was a clear expression of Congressional intent that profits growing out of the defense effort should be subject to excess profits tax. The law, however, has not achieved that objective. Many corporations that are the principal beneficiaries of the defense effort and that hold large government contracts are paying little or no excess profits tax.

In the absence of complete excess profits tax returns an examination has been made of published financial data for certain corporations. One company whose profits in 1940 were more than 3,000 percent larger than in 1939 is subject to no excess profits tax whatever on 1940 earnings and this is a company which has thus far received over \$70 million of defense contracts. A large steel company which has received over \$250 million of defense contracts and had earnings in 1940 of nearly 200 percent larger than in 1939 will pay no excess profits tax. It appears that only 5 out of 12 large integrated steel companies will be subject to excess profits tax on the income of 1940, although steel companies have in general received huge amounts

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of defense orders.

These companies pay little or no excess profits tax because they are allowed a minimum credit of 8 percent of invested capital.

2. Failure to tax profits in excess of a Necessary normal return

Another serious shortcoming of the 1940 excess profits tax law is that profits in excess of a necessary normal return on invested capital are not subject to the tax unless such profits also represent an increase over the profits of the base period. For example, one company which earned during the base period an average of approximately 40 percent on its present invested capital will be free from the excess profits tax on income in any year equal to approximately this 40 percent and will be taxable only on such increases in income as it may enjoy.

This failure of the law to reach a large portion of excess profits is due to the provision of a credit for every corporation equal to 95 percent of its base period earnings, regardless of the size of those earnings in relation to its invested capital.

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III - Remedies

Revisions of the excess profits tax to be considered adequate, must reach the two kinds of profits which I have been discussing. The tax can reach a much larger proportion of defense profits if there is a reduction in the 8 percent credit on invested capital. Profits in excess of a necessary normal return can be reached by taxing all profits above a stated percentage of invested capital, regardless of average base period earnings.

These were the basic elements of the Treasury excess profits tax proposal of 1940, and it is this plan, with modifications dictated by experience, that we suggest. In that proposal corporations were to be allowed tax free their earnings during the base period, but not more than 10 percent of invested capital. However, they were granted a minimum credit of 4 percent of invested capital with 6 percent allowed on the first \$500,000. Thus, under that plan a concern which earned 7 percent during the base period would be allowed to continue to earn 7 percent free of tax. A concern which earned only 2 percent during the base period would

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be permitted to earn 4 percent free of tax. A concern which earned 15 percent during the base period would be allowed to earn 10 percent free of tax.

Under the 1940 Treasury proposal it was recognized that if businesses were to be expanded and investors were to put money into new corporations, an opportunity must be allowed to earn a substantial rate of return on new capital. The plan allowed an 8 percent return, regardless of the earning experience during the base period on old capital.

If the plan submitted by the Treasury last year had been applied in the examples previously presented, the tax results would have been quite different. The corporation which had the 40 percent return on its invested capital in the base period would have paid excess profits tax on about half of its 1940 income instead of on about one-twentieth as under the present law. The large steel company would have paid excess profits tax on over one-third of its income and the other company with poor earnings in the base period would have paid on about one-fifth of its income instead of both companies being entirely exempt.

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Even this plan, however, would have failed to reach substantial amounts of defense profits received by corporations which had especially poor earnings during the base period. To meet this defect we would suggest revising the 1940 proposal to provide that where the average earnings of the base period were less than the minimum of 4 percent, the excess profits tax should be applied at a low flat rate, possibly 10 percent, to that part of the current profits that is in excess of the base period earnings but not in excess of 4 percent of invested capital. For example, if a corporation earned during the base period an average of \$100,000 a year, while 4 percent of its invested capital amounts to \$300,000, the first \$100,000 of profits in the current taxable year would be entirely exempt from excess profits tax, the next \$200,000, representing the difference between the \$100,000 average earnings and the \$300,000 credit on invested capital, would be taxed at 10 percent and any earnings over \$300,000 would be subject to the regular excess profits tax rates. This special rate of tax would subject all increased in profits during the defense period at least

to some excess profits taxation while at the same time not being high enough to impose an undue burden on concerns whose increased earnings are not truly defense profits.

We would suggest also that the rate allowed on new capital be the same as the maximum rate allowed on old capital, namely, 10 percent. Any maximum return on capital must be a somewhat arbitrary figure because businesses differ widely in the degree of risk they face. Accordingly, it is desirable not to set too low a maximum rate of return.

Similarly, it would be desirable to keep the tax rate low on that part of the profit which is immediately above the credit. To this end we suggest that tax rates be graduated in accordance with the rate of return on invested capital with a moderate initial rate. It should be possible to raise the desired revenue with a lower rate scale on the average than under the present law because of the larger amount of profits that will be subject to tax.

Moreover, with this new broad excess profits base, it would be possible to adapt ourselves quickly and

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much more easily to a need for still larger revenues if the emergency should so require. The future is especially uncertain during an emergency period, and we might have to act quickly. It is better to have a broad excess profits tax base carefully worked out while we still have the time than to patch up the present law only perhaps to find ourselves confronted with the necessity of improving such a base on short notice at a later date.

IV. Possible but not preferred alternative

Thus far I have outlined what seem to me to be the principles of excess profits taxation that should be followed in this emergency period and have indicated ways in which the existing law fails to carry them out. If you believe with me in these principles, I believe you will agree that a plan similar to the one I have outlined is the logical method of putting the principles into practical operation. Variation in details is not a matter of concern, so long as the plan adopted fulfills the clear purpose to impose taxes both on defense profits and on excess profits, which is something the present law does not do.

If these principles are not to be the guide for

taring corporations during the emergency period, it might be well to consider carefully the disadvantages of having a tax which involves the administrative difficulties of the present tax, but applies only to part of the profits that it should reach. A simpler, more easily administered plan would, of course, be to abandon the excess profits tax and to increase the corporation income tax by enough to produce the desired revenue. With such an increase in the corporation income tax there should, in my judgment, be coupled a provision for reducing the tax when the earnings of the corporation are immediately made subject to the individual income tax, either through the distribution of dividends or in some other way.

This kind of a plan would be in harmony with the idea of integrating the corporation and the individual taxes, placing chief reliance on the taxation of income individuals. With our experience with previous plans of this general character, many difficulties previously not even very likely to be avoided and equitable taxation of profits to the individual stockholder provided.

I do not set forth this plan as one that carries

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into effect the principles which I previously discussed. It is based on principles of its own and is suggested as an alternative, not a substitute.

We cannot expect to devise a painless tax bill. The situation calls for sacrifices. As Secretary Morgenthau has already told you, we have had unmistakable evidence that the people are willing to make sacrifices according to their ability. Outside the tax field greater sacrifices are being asked and cheerfully made. There is no basis of comparison of the sacrifice of those who are asked to exchange the security of a job and a home for a soldier's pay and a soldier's hardships with the sacrifice of those who are asked to pay even drastically higher rates of tax.

Treasury Department

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TELEGRAPH OFFICE

1941 MAY 15 AM 9 06

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BLF NY AIRPORT NORTHBEACH NY MAY 15 1941 837A

HONORABLE HENRY MORGENTHAU JR
SECRETARY OF THE TREASURY

ARRIVE YOUR OFFICE TEN FORTY FIVE STANDARD SHOUPO ABOUT TWO.

ROSWELL MAGILL

906A

May 15, 1941
9:30 a.m.

GROUP MEETING

Present: Mr. Haas
Mr. Bell
Mr. Thompson
Mr. Cochran
Mr. Coe
Mr. Schwarz
Mr. Kuhn
Mr. Sullivan
Mr. Foley
Mr. Gaston
Miss Chauncey

H.M.Jr: Just so you people know where we are at, right after this meeting Sullivan, Gaston, Foley and I are going in to a huddle on this tax thing, with the exception that you (Bell) want five minutes at eleven just to shake hands with Burgess.

Bell: I haven't heard from him yet. He was to call up this morning.

H.M.Jr: I have cancelled everything except luncheon with Purvis today.

Bell: How about your press conference?

H.M.Jr: I will take that, but everything else I am going to cancel, because I am trying to get this thing into the hands of - and I have

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three assistants that have all dropped everything and are coming by plane. I have got Magill, Greenbaum, Knollenberg, and Shoup coming in at eleven to help us.

I have got to keep my mind on this, because I am trying to get this in the hands of the President tomorrow with the hope that whatever comes out of the - John goes on the Hill Monday, and I can say, "Well, he is talking for the President and me and himself," so that is the way the thing stands.

Now, the most important thing that I seem to have, and I want you to handle this, Dan, this memorandum from Cochran which I haven't read, Clark and Phillips.

Now, I outlined this to Hopkins at lunch yesterday, and he said, O.K; so if this could be written, a photostat with their signatures, and a letter from me to Hopkins which if you can bring in at five minutes of eleven I will sign it so we don't lose any time.

Simply say, "Dear Harry, carrying out our -" something about our luncheon conversation - "this is a formal document and I recommend it to you as the Administrator of the Lend-Lease Bill to be carried out."

Bell: Do you want to say you recommend it or from the standpoint of the Treasury?

H.M.Jr: From the standpoint of the Treasury. I would appreciate as early a reply as possible.

Bell: We will get it this forenoon.

H.M.Jr: This other thing, discussing with Hopkins, for your guidance, and he was outlining his troubles, I mean the War Department and the RFC plus the two hundred fifty to the three hundred million which they say they have been wanting to buy and they can't get, you know.

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Hopkins says, "Well, why not let's lump the two things together and if it is five hundred million dollars, let's wipe out the whole business and give them a five hundred million dollar credit out of Lend-Lease and start fresh. I don't want you to say that to the English yet, you see."

Bell: You are talking now about taking over the contracts plus the Canadian --

H.M.Jr: I am going to pin this on you, Dan, if I may. Cochran has the details. You will do the work as usual.

Bell: No.

H.M.Jr: What do you mean, "no"?

Bell: I mean you do the work.

H.M.Jr: No, what I am getting at is, here is the thing. There are two items. I have given the English my word after consultation with the President that we would immediately take over three or four hundred million dollars worth of contracts placed prior to the fifteenth of March.

Now, when I told - that is Number one. Number two, they say this. There are between two and three hundred million dollars worth of things that they want which they are afraid will not come under the Lend-Lease, the two together amounting to about five hundred million dollars.

Hopkins says that McCloy says that he got word from the White House that the White House didn't want the Army to go ahead, but it is a damn lie. He said as far as he, Hopkins, is concerned, he never gave any such instructions

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to McCloy and has never talked to McCloy.

Bell: Well, I am sending you a memorandum of my conversation with McCloy. He said that he had discussed this with you last week when you went to Aberdeen, and told you that there was some doubt about getting it, but when you had told him that you were committed, then he said he was going back after it and he said he did get word from Hopkins through Burns that we shouldn't take over any more contracts because of Harold Smith's testimony and he said Jesse is also reluctant to go further than the fifty million because of that testimony. He didn't think we ought to go any further under the Lend-Lease Bill.

Now, McCloy is going back to Hopkins and back to Jones in view of your statement to him the day you went to Aberdeen to try to get them to take out the two hundred or three hundred million dollars that you are committed for, and he said he would let me know within forty-eight hours.

H.M.Jr: Well, Hopkins got quite excited. He said, If McCloy said he, Hopkins, told him he shouldn't do it, it is a damn lie.

Now, Hopkins simply said, "If there is this three or four hundred million, we have got to do it, and there is a couple of hundred million - just lump it together and we will call it five hundred million and we will fix them up for five hundred million, but I don't want to get that to the English yet," but there was every disposition on his part to be cooperative and clean it up.

Bell: Well, I thought there was on McCloy's part, too. McCloy said that the British would get approximately fifty million dollars

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from RFC within the next week or ten days on account of the Tennessee powder plant and the machine gun plant.

H.M.Jr: You see, Hopkins knew the Army had said to the English, the way I understand it, that they were taking two or three hundred million of their appropriation and fixing it up and Stimson and McCloy boasted all over what they were doing for the English out of their appropriations and Hopkins knows all about it. He said they never did a damn thing.

Bell: Well, they have taken over two hundred thirty million of contracts that the British were negotiating, but had not completed at the time of the Lease-Lend Bill. Of course, that is no relief, no immediate cash.

H.M.Jr: He said he knew he had his facts correct that the Army was saying they would take over this thing. Out of that thing I think you people can have a couple of meetings, you see, and get it boiled down, have the three or four hundred million - you see, Harold Smith, not knowing, misspoke himself.

After that, they came back and I again reassured them, Phillips, that our position was not changed. After all - so that - you clear the Canadian thing and if you can get the other thing - I think the Canadian thing we ought to be able to clear up this week and then the other thing after we boil down the RFC and the Army, well, we have taken over so much and how much is there left, how much of the things they can't buy.

Cochran: You still have Keynes' memo coming.

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H.M.Jr: That is right. Well, you can tell Clark that it is cleaned up.

Cochran: Then should he go ahead? He is staying over today.

H.M.Jr: He can go home.

Cochran: Should he get in touch with Hopkins for the working of it?

Bell: Shouldn't he? I think so.

H.M.Jr: Why?

Bell: Well, he or Coyne certainly should, and I think Coyne has sort of been given the run-around. I think Clark is the person.

H.M.Jr: No, let this letter go. Let this letter go, and you can put in the letter, if you want to, would he care to discuss this with - this is Treasury to Treasury, between the three Treasuries and this is what we recommend.

Now, I take it that he will work out the details.

Bell: Oh yes. I don't think we ought to suggest to Hopkins that he see Clark, but I think we ought to tell Clark that the memo is gone and if he wants to, he is free to see Hopkins.

H.M.Jr: O.K. Can I forget about it?

Bell: Yes.

H.M.Jr: These are this new scientific follow-up system that I have got. It will work for about three days and I will get mad and throw it in the trash basket.

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"Telephone Conversation Follow-Up:

"In phone conversation on May 8th, Mr. Morgenthau told Secretary Ickes he would try to get some information on stockholders of Aluminum Company in U. S. and the one in Canada, and would let Mr. Ickes know.

"Mr. Morgenthau asked Mr. Foley to get this information for him."

- Foley: They are about eighty-five percent the same. I have got it on my desk.
- H.M.Jr: Do you want this?
- Foley: I can remember it.
- Chauncey: You had better keep that.
- H.M.Jr: Maybe soon, yes?
- Foley: Yes. (Laughter)
- Bell: He is going to be in a hurry for it now.
- H.M.Jr: "In a telephone conversation the Secretary promised Drew Pearson he would take another look at the matter of the Internal Revenue Collector at Toledo."
- Gaston: The Internal Revenue Collector at Toledo? We are still waiting for a recommendation from somebody.
- H.M.Jr: Do you want this as a reminder?
- Gaston: I don't need it. I go over those situations every week. I get a weekly memorandum from Personnel.
- H.M.Jr: Make two copies of this and give one to them.

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Gaston: You know what Drew Pearson's interest there is.

H.M.Jr: I know.
(The Secretary speaks on telephone with Representative Doughton.)

Gaston: He is a sweet old guy.

H.M.Jr: Isn't that wonderful? I think that is marvelous. Why they haven't attacked us in the press on this thing - they have just done nothing, have they.

Schwarz: Nothing. Most of the heat is up there right now, fortunately.

H.M.Jr: I didn't know what the devil I would say at press conference, but I will simply repeat this.

Schwarz: At the request of.....

H.M.Jr: That is pretty nice, John.

Sullivan: Very nice. He has been trying to get me and wanted me to call him back. I think I had better step out and call him.

H.M.Jr: Wait a minute, because it seems too obvious.

Sullivan: He goes into a meeting at ten o'clock. He sent a message in.

H.M.Jr: Oh. All right.

Thompson: You were going to call Jere Cooper about Miss Rhea. (Laughter)

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H.M.Jr: Well, I haven't. That is strike one. O.K., it is too late.

All right.

Thompson: That is all I have.

H.M.Jr: Wonderful. That is marvelous. Go ahead, Dan.

Bell: Do you want to announce at your ten-thirty meeting that you are going to consider financing again next week, and have an open market meeting?

H.M.Jr: Should I say new money and refunding?

Bell: I think I would say a possibility - consider new money and refunding on the August maturity.

H.M.Jr: What is the August maturity?

Bell: It is eight hundred thirty-four million, three and a quarter percent bonds. They were eight year bonds issued by Woodin in 1933.

Haas: They were called the "Woodins."

Schwarz: Splinters?

H.M.Jr: I was just going to say, how did I come to issue a three and a quarter percent bond?

Bell: They were issued in August '33.

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H.M.Jr: What else?

Bell: I have got a lot of stuff that has accumulated, that I didn't get to see you about yesterday. Want me to start?

H.M.Jr: No. (Laughter) What do you want? You shouldn't have asked me.

Bell: Well, I have a number of things. I don't think it will take so long. Five minutes, ten minutes.

H.M.Jr: Let me run around the room and then maybe I will give you five minutes alone, how will that be?

Bell: All right, fine.

H.M.Jr: There is no criticism, Chick, on the whole thing. It is the most amazing thing.

Schwarz: There is confusion.

H.M.Jr: Thank God the newspaper men in Washington are lazy. They are; they are the laziest crowd I ever saw.

Chauncey: Did you see Cecil Dickson's column this morning? He spoke about Mr. Eccles and Mr. Henderson.

Bell: This morning's Post, isn't it?

H.M.Jr: Is it interesting?

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Schwarz: I don't think so. It just struck me as being routine.

H.M.Jr: Was it unpleasant?

Chauncey: No, no.

Schwarz: No, just routine.

H.M.Jr: What did it say.

Schwarz: Just mentioning Eccles and Henderson and wondering whether that was holding things up.

Bell: A little indication that they might have had the approval of the White House.

Sullivan: He (Doughton) has already made the request.

H.M.Jr: Anything else?

Schwarz: That is all.

H.M.Jr: Can you imagine if Johnny Hanes was handling taxes and there being nothing in the papers?

Schwarz: The New York Times editorial page would have something.

(Mr. Haas handed a report to the Secretary.)

It is just one page. I tried to get it all on one page.

H.M.Jr: I have got to read this.

Haas: There is only one other thing that you will probably want to do something about today. Colonel Ayres says he can't give us any more of those figures because the Secretary

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of War has spoken to him about it, and he has to get some release from Stimson again. He said previously he was giving it to us, and he thought that on the basis that you were making up something for the President, but he wonders about this other, and in view of the fact that Stimson spoke to him, he has to hold it up until the Secretary of War says something that releases him again, so we are - he said he would go ahead, however, and get the figures and assumed that he would get the relief.

H.M.Jr: Write a little note to Secretary Stimson:

"My dear Harry: Colonel Ayres is under the impression that you do not want him to give me any more statistics on production - any more production figures on munitions. I would appreciate it if you would direct him to give Mr. George Haas the figures - give him the information that he wants with the understanding that this information is for myself - this information is only for the President and myself. Yours sincerely."

And send it over.

Haas: Thank you. That is all.

Kuhn: Nothing, sir.

Coe: We have a brief story here on the Canadian budget that, as you know, is very stiff. You might put it in your files.

H.M.Jr: All right. Anything else?

Cochran: I have incorporated this copy of the letter from Hopkins to Purvis on India in the

- 13 -

memo which I wrote up of Keynes' conversation yesterday.

Sullivan: There were some vacancies on the Processing Tax Board of Review. Mr. Doughton, about two months ago, spoke to me about being very anxious to get a man in there, but he didn't want to put anybody in if we didn't need to fill the vacancy, and we reported to him that we didn't think it would be necessary to fill the vacancy at this time. Since then Stewart McDonald has resigned to go as counsel for Sayre in the Philippines, and yesterday morning "Skeeter" Johnston, the Clerk of the Senate Finance, called and said that Pat Harrison had called him and was very much interested in a special attorney over in the Processing Tax Section of the Appeals Division, and that he would like very much to have him appointed, and I suggested he write me a letter about it. I think I had better just write him back and tell him we are making a survey to see if it is necessary to fill this vacancy. We are going to have a conflict between Pat Harrison and Mr. Doughton, otherwise.

That is all except Irene Dunne's husband left this memorandum that I promised to get to you.

H.M.Jr: Is that a picture of Irene?

Sullivan: No.

H.M.Jr: Well, you gave it to me.

Sullivan: I gave it to you. That is all I wanted to be able to say.

H.M.Jr: All right?

Sullivan: Yes, sir.

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H.M.Jr: How about our friend--

Foley: Yes, that - he, Weinberg, is the fellow that did that job on McKesson-Robbins, and this fellow hadn't anything to do with it.

H.M.Jr: Is he clean?

Foley: Yes, he is clean.

H.M.Jr: Will SEC give him a clean bill of health?

Foley: They don't know what he has been doing lately. They have lost track of him since the Investment Trust study. I have got a little memorandum. I talked to Sumner Pike and Dave Schenker and Ganson Purcell.

He was partner in Goldman Sachs. He handled an investment portfolio, and it disappeared under him like ice in the summer, but he wasn't connected with the McKesson-Robbins thing, and they didn't know anything against him other than that--

H.M.Jr: He has been out of it ten years.

Foley: Yes.

H.M.Jr: What is his business now, do you know?

Foley: Somebody said that he was chairman of Schloss and Sheffield Steel Company in Birmingham, Alabama.

H.M.Jr: Is that Katchings?

Foley: Yes.

H.M.Jr: Do you know the story?

Kuhn: Yes.

H.M.Jr: He wants to be chairman of this committee to handle this radio hour. They say he is in the business of advising companies. He isn't the kind of man that I would like associated with the Treasury.

Haas: He is labeled with the Blue Ridge Corporation, Shenandoah.

Foley: That is right.

Coe: He was in the earlier part of McKesson.

Foley: His partner, Sidney Weinberg, worked with Foster.

Gaston: He wrote all those books, you know, on various economic subjects. One of them became very famous.

Haas: I don't remember. Foster was the educator and tax specialist.

Gaston: He has been interested in radio, music, and that sort of thing.

H.M.Jr: Ferdie, What's-his-name isn't here today, so I wish you would look into it a little bit more. Tell him that after thinking it over I am perfectly willing to accept Texas Company's hour, but I don't want to accept Waddell Katching's.

Is he the man that brought it to us? Look into it, will you please?

Kuhn: Is the rest of the proposed committee all right with you.

H.M.Jr: I think it is a terrible committee. But he said he had to have a decision on the hour. If they want that, that is all right. But

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I am very loath to take Waddell Katchings or the people on the committee. But I won't be able to hit it today.

Gaston: Our political committee held a meeting yesterday on the western Pennsylvania Collector of Internal Revenue, and we have reached a decision subject to your approval which, when we inform Guffey, as we shall have to, he will come rushing to you and probably to the White House with blood in his eye, but we don't see any alternative. That is this. He has named four third-rate men as possibilities, and we can find one of those men, who can be recommended, but, at the same time, he lets us know that he proposes to have this entire Collector's office cleaned out, all the principal deputies dismissed and his new appointees put in before the Ramspeck Law becomes effective, and we propose to tell Guffey that while we will recommend his man for appointment that there will be no dismissals except for cause and except on the approval of the Commissioner of Internal Revenue.

H.M.Jr: Sounds all right to me this morning.

Gaston: Of course Guffey is going to be awfully mad because he simply wants to wreck that office, and we don't think we ought to let him do it.

H.M.Jr: Remind him about Lawrence, and I don't mean "Lawrence of Arabia." (Facetiously)

Gaston: David?

H.M.Jr: Yes. All right.

Now I can see Gaston and Foley and Sullivan at ten after ten, and that gives Mr. Bell ten minutes.

MAY 15 1941

Dear Harry:

You will recall that during our luncheon conversation yesterday I told you that I expected to receive from Mr. V. G. Clark, Deputy Minister of Finance of Canada, a statement to be initialed by Sir Frederick Phillips, Under Secretary of the British Treasury, and himself, setting forth a Canadian proposal for lend-leasing of goods acquired in the United States by Canada which subsequently enter into exports from Canada to Great Britain.

There is attached a photostatic copy of the statement which was received from Mr. Clark yesterday. The financial arrangements outlined therein are acceptable insofar as the Treasury Department is concerned. It is, however, for you as Administrator of the Lend Lease program to determine the execution of the plan. I shall appreciate it if you will inform me of such action as you may take in the premises.

Yours sincerely,

(Sgd.) Henry

The Honorable
Harry L. Hopkins,
The White House.

Sent by Special Messenger
may 15/41 - 11:15 am

HMC:lap-5/15/41

Init: HMC - AWB

(Handed by Mr. Clarke, Deputy Minister of Finance of Canada, to Mr. Cochran in the Treasury at 4 p.m., May 14, 1941.)

Washington, May 14th, 1941.

From April 20th, 1941, to June 30th, 1942, it would be necessary for Canada, under present programs to spend approximately \$220 million in U.S. funds for purchases in the United States of articles and materials required for Canadian production for the United Kingdom. In the Hyde Park Declaration of April 20th, 1941, it was agreed that "in so far as Canada's defense purchases in the United States consist of component parts to be used in equipment and munitions which Canada is producing for Great Britain....Great Britain will obtain these parts under the Lease-Lend Act and forward them to Canada for inclusion in the finished articles."

Part of the estimated amount of \$220 millions represents the value of defense articles which retain their identity in the process of being incorporated in Canada into war supplies for the United Kingdom, or which are otherwise readily identifiable and capable of being dealt with directly and effectively under the machinery of the Lease-Lend Act. The balance consists of a very large number of items, including materials, which it would be very difficult so to identify and administer, involving thousands of contracts which would individually represent very small sums. At present it is estimated that the former category will amount to approximately \$120 million for the period mentioned, and the second category to about \$100 million.

Pursuant to the Hyde Park Declaration, it is agreed that the United Kingdom will obtain under the Lease-Lend Act for forwarding to Canada, defense articles up to a total value of approximately \$220 million, or such amount as may be determined from time to time to represent the actual value of the "United States content" of Canadian War Supplies to the United Kingdom. In part these will be the actual articles represented by the first category mentioned above. Articles coming within the second category will continue to be purchased in the United States and paid for in cash by Canada, but Canada will be compensated by other defense articles to an equivalent value, which it would otherwise have to purchase in the United States. These will be obtained by the United Kingdom under the Lease-Lend Act and transferred to Canada.

The object of this understanding is to carry out the purposes of the Hyde Park Declaration so that Canada shall not have to pay out U.S. dollars to purchase U.S. goods which are ultimately to be supplied to the United Kingdom.

W. B. Clarke
#Phillips

MAY 15 1941

My dear Cordell:

I have pleasure in attaching a copy of a letter, together with its enclosure, which I have written Harry Hopkins today. If you or any members of your Department may desire further information with respect to the subject dealt with in this correspondence, Harlo Cochran of my staff will be glad to provide it.

Sincerely yours,

(Signed) Henry

Attachment:
Letter and enclosure.

The Honorable
Cordell Hall,
Secretary of State.

By Messenger 5⁴⁵


HMC:149-5/15/41

TREASURY DEPARTMENT

INTER-OFFICE COMMUNICATION

DATE May 15, 1941

TO Secretary Morgenthau
FROM Mr. Cochran

STRICTLY CONFIDENTIAL

At 11:15 this morning my office sent to Mr. Hopkins at the White House the Secretary's letter covering the memorandum submitted by Messrs. Clark and Phillips in regard to the Canadian proposal for lend-leasing of goods acquired in the United States by Canada which subsequently enter into exports from Canada to Great Britain. Fifteen minutes later I telephoned the Canadian Legation. Mr. Clark was not present, so I spoke with Mr. Coyne.

I told Mr. Coyne that the Secretary had brought up the Canadian proposal with Mr. Harry Hopkins when the latter lunched with the Secretary yesterday noon. The Secretary thought that he had made good progress in advancing the proposition with Mr. Hopkins. I added that we had just sent over to Mr. Hopkins a photostatic copy of the memorandum under reference. The way was thus prepared for the Canadians to approach the Lend-Lease administration directly to determine working arrangements under the plan. I told Mr. Coyne that we thought it might be advisable that Mr. Clark should take advantage of his presence in Washington today to get directly in touch with Mr. Hopkins and see whether the inauguration of the plan might be expedited through their personal contact. From then on the negotiations would presumably be between Mr. Coyne and Mr. Hopkins' assistants, Cox and Young. Mr. Coyne appreciated this suggestion and said that he would pass it on to Mr. Clark at once and then let us know of developments.



May 15, 1941
9:45 a.m.

H.M.Jr: Hello, Bob.

Cong. Robert Doughton: That you, Henry?

H.M.Jr: It is, in person, in the flesh.

D: How's that?

H.M.Jr: I'm here in person.

D: All right. After thinking over the matter that you spoke to me about yesterday afternoon, you know, about not coming down until Monday, I studied up this piece of strategy and see how it suits you.

H.M.Jr: Good.

D: I thought it might relieve the situation a little all around.

H.M.Jr: Please.

D: You see, yesterday we didn't get to work much as we had to be on the floor of the House most of us and didn't conduct hearings in the afternoon, so we've got quite a number of witnesses that were calendared for today and ready to be here tomorrow from out of town, as many as we can hear.

H.M.Jr: Yeah.

D: So I thought I'd just assume the responsibility of saying that I didn't think it was fair to hold these out-of-town witnesses here over until next week and that the Treasury could come at convenience and I'd just take the responsibility of saying that we'd take care of these out-of-town witnesses today and tomorrow and that I'd request you all to come Monday.

- 2-

H.M.Jr: Well, you're a Southern gentleman!

D: Well, I'll just take the responsibility and you see that relieves you of any embarrassment and gives me a perfect justification.

H.M.Jr: Well, that's wonderful. I've just been sick about it.

D: Well, of course, I aimed to have had you to come tomorrow and let these other people go over, but you see that gives not only a good excuse, a good justification.

H.M.Jr: Well, John will be up there Monday ready to go.

D: Well, we'll tell them you folks were - are you coming or Mr. Sullivan?

H.M.Jr: No, John will be there.

D: Call on him for the first witness/^{Monday}and give him all the time he wants.

H.M.Jr: That's right.

D: Then we'll go over two or three days so if anybody wants to rebut what he says why they can do it.

H.M.Jr: Well, I can't tell you how much I appreciate that.

D: Well, I just thought that would be a good way to solve the situation and there would be no criticism in the world of you for postponing it from day to day.

H.M.Jr: Well, it's a brilliant suggestion.

D: Well, thank you. Thank you. Good-bye.

May 15, 1941

My dear Henry:

Colonel Ayers is under the impression that you do not want him to give me any more production figures on munitions.

I would appreciate it if you would direct him to give Mr. George C. Haas, Director of Research and Statistics, the data he wants with the understanding that this information is only for the President and me.

Yours sincerely,

(Signed) Henry

Honorable Henry L. Stimson,
Secretary of War.

By Messenger 3¹⁵

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Yours sincerely,

(Signed) Henry

Honorable Henry L. Stimson,
Secretary of War.

By ~~Handwritten~~

May 15, 1941
10:30 p.m.

RE TAXES

Present: Mr. Foley ✓
Mr. Kades ✓
Mr. Knollenberg ✓
Mr. Helvering ✓
Mr. Blough ✓
Mr. Shoup ✓
Mr. Kuhn ✓
Mr. Greenbaum ✓
Mrs. Morgenthau ✓
Mr. Gaston ✓
Mr. Sullivan ✓

H.M.Jr: Professor Blough.

Blough: Well, we have got the next draft, all but the last page which is still in the hands of the typists.

H.M.Jr: How are you feeling?

Blough: Well, so far, fine. Let's see. I have not too many copies here, unfortunately.

H.M.Jr: Well, you are going to read it out loud, aren't you?

Blough: Yes.

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"My purpose today is to discuss with you the problem of corporate taxation in the present emergency. What I shall have to say is supplementary to the statement made by Secretary Morgenthau when the current hearings were opened and to the suggestions laid before you subsequently on behalf of the Treasury Department.

"The Treasury is called upon to meet expenditures greater than have ever been made in the nation's peacetime history, and probably greater than at any period in our history, in peace or war. At such a time we cannot expect to rely on normal sources of revenue or be content with revenue in normal amounts. We must adopt extraordinary measures to deal with our extraordinary situation.

"Your Committee is now formulating changes in our tax system, both to provide the revenues needed to finance the defense expenditures that we are committed to make, and also to assist in maintaining the economic health of the nation. Our people know that we are faced with a great challenge. They know that great sacrifices must be made and they are prepared to make them. They rely upon us so to plan our financial program that, however severe its burdens may have to be, they will rest fairly and justly upon all individuals and all businesses.

"The tax program which you will propose will necessarily consist of many elements. Any one tax, viewed by itself, may appear to be stringent and oppressive. All must be viewed, however, as parts of a whole. This is an emergency. Taxes that would not be proposed in peace times are a necessity now. We cannot give effect to all those niceties of exemptions and saving clauses that are appropriate to

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easier occasions but today will defeat our ends.

"I have been asked particularly to discuss the excess profits tax, first enacted in the fall of 1940. Our experience with it is still limited, for many of the returns of the largest corporations have not yet been filed. Enough have been filed, however, to convince Treasury officials in charge of administration that important changes in the law must be made in the interests of fairness. We are collecting large sums by means of this tax, but the profits of a good many business firms are not being touched by the tax, although those profits appear to be excess profits by any standards that seem reasonable."

H.M.Jr: Wait a minute, please.

Foley: Insert "to be."

H.M.Jr: "Appear to be," is that it?

Foley: That is right.

Blough: Yes.

H.M.Jr: Just a second. "Appear to be excess profits by any - " can't you--

Blough: "Any reasonable standard."

H.M.Jr: Well, "by any - " I am thinking of the word "normal." I don't want to use it too much.

Kuhn: Instead of "appear to be," "those profits are excess profits."

Blough: "Although all those profits are excess--"

H.M.Jr: "By any reasonable standard," something like that.

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Blough: "Here is certainly a place to broaden the base. Surely the skill of this Committee and its experts is adequate to the task of bringing within the tax the known cases of corporate excess profits."

H.M. Jr: Just one second. You see, there has been all this stuff in the paper about broadening the base, which means we should make the person with small income pay more and they bring it in here, the place that we think is the place to broaden the base is on people who aren't paying excess profits which I think is very clever. I didn't write it, so I can say it.

Blough: That is Magill.

"I want first to outline the principles which I believe should govern the taxation of excess profits; second, to indicate respects in which the present law fails to accord with those principles; and third, to suggest possible remedies which the Congress may wish to consider.

"I - Principles

"Under present conditions some kinds of profits may be appropriately subjected to heavier taxation than other kinds. This may be necessary in order to distribute the burden fairly and to avoid unfavorable economic effects that might result if the revenue were raised in other ways.

"1. Defense profits"

These headings, of course, you will drop out in reading the statement.

"The first type of profits which should, in a period of this kind, be subjected to special

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taxation comprises the profits which may be reasonably attributed to the defense program. Such profits are being made out of the sacrifices of the people as a whole and should be returned to the people in taxes, insofar as may be possible without destroying necessary incentives to produce defense goods.

"In a majority of cases it is not possible to distinguish with precision the additional profits due to the defense program. The effects of defense spending are diffused throughout the whole economic system. It is necessary, accordingly, to assume that in general, increases in profits during this period are due to defense. Some relief can and should be granted where it is clear that this is not the case. Inability to measure defense profits precisely should not discourage us from subjecting them to special taxation even at the risk of hitting some incomes not due to the defense program."

H.M.Jr: Just a minute, please.

Foley: What is it, the word "due"?

H.M.Jr: Just the "Inability to measure defense profits precisely should not discourage us from subjecting a special tax - " this part. "Even at the risk of hitting some incomes not due to the defense program."

Foley: "Coming from the defense program."

Gaston: "Not arising from."

Sullivan: The sentence before that is the one that disturbs me.

H.M.Jr: What is that, John?

Sullivan: "Some relief can and should be granted where it

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is clear that this is not the case."

What happens to your excess profits tax part under that sentence, Roy?

Blough: Well, this is increases in profits, and it is under this one section on defense profits. We may have to reword that to make sure we don't want to let them out entirely. It is simply under this title, as you might say.

Sullivan: I think we had better--

Blough: It may be the sentence as a whole could be taken out.

Knollenberg: Isn't that an invitation to the kind of tampering--

Blough: In view of the fact that the last sentence indicates the possibility of not measuring it precisely, it may be that that sentence should come out.

H.M.Jr: Why don't you put a bracket around it and think about it?

Blough: All right.

Greenbaum: In the first sentence there, do you want to say, "In the majority" or "In many of the cases"?

Foley: "In many cases."

Greenbaum: "In many cases," I think, is better.

Blough: All right.

Kades: At that point, Roy, would you want to say that relief has already been granted through the amendments made this year? And some more perhaps should be made?

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Sullivan: No. That type of relief hasn't been granted, Chuck.

Kades: Isn't this abnormal profits that you are speaking of?

Blough: There has been some relief in that abnormally low income in the base period and so on, has had relief granted to it and it has been adjusted and the Commissioner is given power to make certain other adjustments.

Sullivan: That hasn't depended upon whether or not it was derived from a defense program. That is what I am afraid of.

Blough: That is true. It has decreased the profits in some cases, I mean decreased the apparent profits for taxation. Perhaps we might give a little more thought to that point.

"2. Profits in excess of a necessary return on invested capital

"The other kind of profits that can properly be subjected to special taxation are profits in excess of a necessary normal return on invested capital, even if this return was being earned in the years prior to the defense program."

"Necessary normal" has been put in to replace the "reasonable," which you didn't like.

H.M.Jr: Which his Papa didn't like. (Laughter)

Sullivan: Would not have liked.

Blough: "The existence of such profits, while often due primarily to good management, are in numerous cases due to monopoly, imperfect competition, or fortunate circumstances, and not to any

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outstanding service to the public. These profits represent in large part money taken from consumers in excess of the amount necessary to produce the goods or services. When the imperfections of our economic machine have permitted this to happen, it is equitable and desirable that the excess profits be subjected to special taxation."

H.M.Jr: Excuse me, this is new, isn't it?

Blough: No.

H.M.Jr: Isn't that something new?

Blough: The only thing that is new is "fortunate circumstances" in place of luck and chance, which his Papa didn't like either.

"Furthermore, at a time when heavy taxes must be imposed they should be levied where they will assist best in maintaining a well-functioning economy."

That is to replace "hard on the economy," or whatever we had before.

"To take an especially large share of the profits in excess of a normal return on invested capital will not cause any companies to go into bankruptcy or withdraw from business.

"I am aware that the anticipation of extraordinarily large profits may in many cases have put security prices well above a figure that would represent invested capital. The imposition of these special taxes may seem harsh to individuals who have purchased those securities at such levels. We cannot entirely disregard this aspect of the problem, but we must remember that no legislation is ever passed and no progressive step is ever taken

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which does not disturb the established interests of some people. We submit that established expectations of high profits are entitled to no more protection than an individual's expectation of a continued large salary, now subject to a heavy tax. This is an emergency and changes must be expected.

"I am also aware that the application of the principle of taxing profits in excess of a necessary normal return on capital involves difficulties of both principle and technique. I feel sure that we should not allow these difficulties to stand in the way of our seeking to attain the main objective.

"II - Defects of the present Law

"In the light of the principles just stated, let us now examine the excess profits tax law passed last year, to see in what respects, if any, it fails to correspond to them.

"1. Failure to reach large parts of defense profits

"The Excess Profits Tax Act of 1940 was a clear expression of Congressional intent that profits growing out of the defense effort should be subject to excess profits tax. The law, however, has not achieved that objective. Many corporations that are the principal beneficiaries of the defense effort and that hold large government contracts are paying little or no excess profits tax."

H.M.Jr:

Just one minute. You wouldn't say here, at this time - I am just raising it - instead of saying "Congressional" bringing in the fact that the President sent a message on excess profits?

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Foley: Well, the bill wasn't responsive to the message, was it?

H.M.Jr: The message preceded it, if I remember correctly.

Foley: Yes. The message supported the Treasury proposal which wasn't adopted.

H.M.Jr: I am thinking of the fact that we are going back to it. If we go back to the President's message and bring it in here--

Foley: Then you would have to distinguish between the message and the act that was supported by the message and what became a law.

H.M.Jr: Then let's consider it again when we go back to our last year's proposal and possibly bring in the President's message. What?

Foley: Yes. I think it would be good to get that back in there.

H.M.Jr: That might be - and to quote some of it. Has anybody got that?

Kades: I will get it.

H.M.Jr: Will you please?

Go ahead.

Blough: We are at the end of the first paragraph.

"In the absence of complete excess profits tax returns an examination has been made of published financial data for certain corporations. One company whose profits in 1940 were more than 3,000 percent larger than in 1939 is subject to no excess profits tax whatever on 1940 earnings and this is a company

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which has thus far received over \$70 million of defense contracts. A large steel company which has received over \$250 million of defense contracts and had earnings in 1940 of nearly 200 percent larger than in 1939 will pay no excess profits tax. It appears that only 5 out of 12 large integrated steel companies will be subject to excess profits tax on the income of 1940, although steel companies have in general received huge amounts of defense orders.

"These companies pay little or no excess profits tax because they are allowed a minimum credit of 8 percent of invested capital.

"2. Failure to tax profits in excess of a necessary normal return

"Another serious shortcoming of the 1940 excess profits tax law is that profits in excess of a necessary normal return on invested capital are not subjected to the tax unless such profits also represent an increase over the profits of the base period. For example, one company which earned during the base period an average of approximately 40 percent on its present invested capital will be free from the excess profits tax on income in any year equal to approximately this 40 percent and will be taxable only on such increases in income as it may enjoy.

"This failure of the law to reach a large portion of excess profits was due to the provision -" or is due - "to the provision of a credit for every corporation equal to 95 percent of its base period earnings, regardless of the size of those earnings in relation to its invested capital.

"III - Remedies

- 12 -

"Revisions of the excess profits tax to be considered adequate, must reach the two kinds of profits which I have been discussing. The tax can reach a much larger proportion of defense profits by reducing the 8 percent credit on invested capital. Profits in excess of a necessary normal return can be reached by taxing all profits above a stated percentage of invested capital, regardless of average base period earnings.

"These were the basic elements of the Treasury excess profits tax proposal of 1940, and it is this plan, with modifications dictated by experience, that we suggest. In that proposal corporations were to be allowed, tax free, their earnings during the base period, but not more than 10 percent of invested capital. However, they were granted a minimum credit of 4 percent of invested capital with 6 percent allowed on the first \$500,000. Thus, under the Treasury plan a concern which earned 7 percent during the base period would be allowed to continue to earn 7 percent free of tax. A concern which earned only two percent during the base period would be permitted to earn 4 percent free of tax. A concern which earned 15 percent during the base period would be allowed to earn 10 percent free of tax.

"Under the Treasury proposal it was recognized that if businesses were to be expanded and investors were to put money into new corporations, an opportunity must be allowed to earn a substantial rate of return on new capital. The plan allowed an 8 percent return, regardless of the earning experience during the base period on old capital.

"If the Treasury plan had been applied in the examples previously presented, the tax results

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would have been quite different. The corporation which had the 40 percent return on its invested capital in the base period would have paid excess profits tax on about half of its income instead of on about one-twentieth under the present law. The large steel company would have paid excess profits tax on over one-third of its income and the other company with poor earnings in the base period would have paid on about one-fifth of its income instead of both companies being entirely exempt.

"Even this plan, however, would have failed to reach substantial amounts of defense profits received by corporations which had especially poor earnings during the base period. To meet this defect we would suggest revising the 1940 proposal to provide that where the average earnings of the base period were less than the minimum of 4 percent, the excess profits tax should be applied at a low flat rate, possibly 10 percent, to that part of the current profits that is in excess of the base period earnings but not in excess of 4 percent of invested capital. For example, if a corporation earned during the base period an average of \$100,000 a year, while 4 percent of its invested capital amounts to \$300,000, the first \$100,000 of profits in the current taxable year would be entirely exempt from excess profits tax, the next \$200,000, representing the difference between the \$100,000 average earnings and the \$300,000 credit on invested capital, would be taxed at 10 percent and any earnings over \$300,000 would be subject to the regular excess profits tax rates. This special rate of tax would subject all increases in profits during the defense period at least to some excess profits taxation while at the same time not being high enough to impose an undue burden on concerns whose increased earnings are not truly defense profits.

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"We would suggest also that the rate allowed on new capital be the same as the maximum rate allowed on old capital, namely, 10 percent. Any maximum return on capital must be a somewhat arbitrary figure because businesses differ widely in the degree of risk they face. Accordingly, it is desirable not to set too low a maximum rate of return.

"Similarly, it would be desirable to keep the tax rate low on that part of the profit which is immediately above the credit. To this end we suggest that tax rates be graduated in accordance with the rate of return on invested capital with a moderate initial rate. It should be possible to raise the desired revenue with a lower rate scale on the average than under the present law because of the larger amount of profits that will be subject to tax."

- H.M.Jr: Wait a minute. I don't understand that sentence.
- Blough: "It should be possible to raise the desired revenue," whatever amount you want from this source, "with a lower rate scale on the average than under the present law," because we get in more profits under the tax by the changes which we suggest.
- Sullivan: And an additional number of corporations, too.
- Foley: Based wider.
- Blough: That is the broadening of the base.
- H.M.Jr: Okey-doke.
- Blough: "Moreover, with this new broad excess profits base, it would be possible to adapt ourselves

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quickly and much more easily to a need for still larger revenues if the emergency should so require. It is far better to have such an instrument at hand than to patch up the present law only perhaps to find ourselves confronted with the necessity of improvising a broader base at a later date.

"IV. Possible alternative

"Thus far I have outlined what seem to me -" now this is all new from now on - "Thus far I have outlined what seemed to me to be the principles of excess profits taxation that should be followed in this emergency period and have indicated ways in which the existing law fails to put these principles into operation. If you believe with me in these principles, I believe you will agree that a plan similar to the one I have outlined is the logical method of putting the principles into practical operation. Variation in details is not a matter of concern, so long as the plan adopted fulfills the clear purpose to impose taxes both on defense profits and on excess profits, which is something the present law does not do.

"If these principles are not to be the guide for taxing corporations under the defense program--"

Sullivan: "During", shouldn't that be?

Blough: "During the defense program."

Sullivan: "During the emergency period."

Blough: "... during the emergency period, it seems to me that you should consider carefully the disadvantages of having a tax which involves

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the extra administration of the present tax, but applies only to part of the profits that it should reach. It may well be that in such case a simpler, more easily administered and more uniform plan would be to abandon the excess profits tax and to increase the corporation income tax by enough to produce the desired revenue. Such an increase in corporation income tax should, in my judgment, have as an integral part of the plan, relief from the tax to the extent that the earnings of the corporation are immediately made subject to the individual income tax, by the distribution of dividends or in any other way."

Gaston: I think that is a trifle vague, Roy. Instead of saying "to the extent that," "of that portion of the earnings which is distributed in cash dividends."

Blough: Well, we were intentionally vague because we didn't know whether you would want to exempt all of the tax, all of the increase, or just something else, and we didn't want to get too far out on the limb at this stage. Perhaps we could make it sound more precise and still be conveniently vague.

H.M. Jr: This is disguising the undistributed profits tax by using about four times as many words.

Gaston: In reverse.

Blough: "Such a plan would be in harmony with the idea of integrating the corporation and the individual taxes, placing chief reliance on the taxation of income to individuals. With our experience with previous plans of this general character, many difficulties previously met can very likely be avoided and equitable taxation of profits to the individual stockholder provided.

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"I do not set forth this plan as one that carries into effect the principles which I previously discussed. It is based on principles of its own and is suggested as an alternative, not a substitute.

"The revenue measure you are considering--"

H.M.Jr: Just a second. Let me just read that part. O.K.

Blough: "The revenue measure you are considering is part of a broad plan not only to spread the burden fairly but also to prevent the price level from rising unduly. The sale of Defense Savings Bonds is another part of that plan. Both taxation and Defense Bonds can absorb money that would otherwise flood the market for civilian goods where it might drive prices up. The Treasury recognizes its responsibility for assisting in the development of a fiscal policy that will prevent inflation. This aim can be achieved only if the proper proportion of total expenditures is raised by taxes and by the sale of bonds that draws in money which might otherwise force the price level up. That proportion will change as our defense program proceeds. For the time being, I believe that we can continue along the lines that I suggested when I appeared before you at the Hearings on the Public Debt Act of 1941--"

Sullivan: That should be Secretary Morgenthau.

Gaston: That should be Secretary Morgenthau and it should be--

H.M.Jr: I think it is terribly funny they have got the word "me" in there.

Sullivan: What is so funny about it?

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- H.M. Jr: You don't think it is so funny. (Laughter)
- Sullivan: I think it is a very natural error.
- Blough: In other words, put it on this bill and not on the former bill.
- Gaston: That is right.
- Blough: You hadn't seen the hearings on this bill, had you?
- Shoup: No, I hadn't
- Blough: ".... that is, aim at raising approximately two-thirds of the expenditures by taxation on a full fiscal year basis. At least this is so if the public responds by investing in Savings Bonds substantial sums of money that would otherwise have gone to swell the stream of non-essential expenditures."
- Sullivan: I think that is a dangerous sentence, Roy. I think that raises doubt as to whether or not we are going to raise the money in Defense Savings.
- Shoup: It is a matter of a safeguarding sentence for the two-thirds, of course.
- Sullivan: Yes, I understand, but it might be picked out and used out of the context.
- Gaston: I don't know, is that dangerous? It says to people, "You had better buy Savings Bonds if you don't want to have higher taxes."
- Kuhn: You are already saying you are aiming at two-thirds, one-third. You are not promising that you are going to stick to that.

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Greenbaum: I think John is right. It indicates a doubt and uncertainty as to what that will be. Of course there is a doubt, but I hate to emphasize it.

Shoup: The people have to be told, I think, pretty plainly that if they don't cut their consumption through investment in Savings Bonds, it is going to have to be cut by taxes and the sooner they learn it perhaps the better.

H.M.Jr: I am not sure, John, I agree with you.

Sullivan: All right, sir.

H.M.Jr: I am not sure. I would like to take another look at all of this in the morning.

Sullivan: Yes.

Blough: "But at a later stage the proportion that we need to raise by taxation will be higher."

Shoup: Now maybe you would want to qualify that.
"May well be higher."

Blough: "The Treasury is studying this problem and, as the defense program develops, will from time to time be prepared to suggest the proper proportions and the means of translating them into practice.

"We cannot expect to devise a painless tax bill."

H.M.Jr: Just one minute. Couldn't you possibly put in here - I want to reread that part anyway beginning with fifteen. This thought, that we can try to do our part, but there are other things which the Congress may do - now I don't know - such as the eighty-five percent parity of Agriculture, which may

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completely throw this whole thing out of its proper perspective and make it impossible for us. I mean, I am just raising that. I don't know whether I want to say that, but I am just raising it. You may not want to be definite or simply say, "We can do our part but we always want to bring respectfully to Congress' attention that they may, on the other hand, do something that no matter what we do, it throws the national economy out of gear." You don't have to mention eighty-five percent parity, but something. I don't want to get it in the people's mind that, after all, taxes and Defense Bonds can solve the inflation problem, particularly if Congress can do what they did here the other day through statute, fix the prices of a very large proportion of the agricultural products. I mean, you might just be thinking about that, you see. I mean, it is just - kind of throws the thing into their teeth.

Shoup: It should give them a sense of joint responsibility.

H.M.Jr: Yes. So they can say later on, "Well, the Treasury said if we gave them the kind of tax bill they wanted and if their Defense Bonds went well, everything is going to be lovely about inflation. Why didn't it work? The Treasury said it would." Here we are putting in a hedge. Would you kind of--

Shoup: Yes, indeed.

H.M.Jr: Thanks. Go ahead, Roy.

Blough: "We cannot expect to devise a painless tax bill. The situation calls for sacrifices. As Secretary Morgenthau has already told you, we have had unmistakable evidence that the people are willing to make sacrifices according

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to their ability. It seems to me permissible to remind ourselves again that outside the tax field greater sacrifices are being asked and must be asked. There is no basis of comparison of the sacrifice of those who are asked to exchange the security of a job and a home for a soldier's pay and a soldier's hardships with the sacrifice of those who are asked to pay even drastically higher rates of tax."

H.M.Jr: On the whole, I think it is a wonderful statement.

Knollenberg: I think it is a masterpiece.

H.M.Jr: I think it is marvelous, Roy. I can't tell you how pleased I am. When you consider you started this morning at nine and here it is eleven at night, it is amazing. Just this one little thing, Roy. "It seems to me permissible greater sacrifices are being asked--" it seems to me you could say, "are being asked and being made."

Greenbaum: "Have been cheerfully given."

Blough: "Are being asked and cheerfully given"?

H.M.Jr: Something like that.

Kuhn: Roy, do you have to say that "It seems to me permissible to remind ourselves"? Couldn't you just say that outside the tax, sacrifices are being made and cheerfully given?

H.M.Jr: I am jealous as hell of you giving this.

Sullivan: Want to cut the deck?

H.M.Jr: Do you mind, Roy, beginning again on page fifteen?

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- Blough: "The revenue measure you are considering is part of a broad plan not only to spread the burden fairly but also to prevent the price level from rising unduly. The sale of Defense Savings Bonds is another part of that plan. Both taxation and Defense Bonds can absorb money that would otherwise flood the market for civilian goods where it might drive prices up."
- H.M.Jr: Now, right there. "Where it might drive prices up." Isn't it strong enough just to say "flood the market for civilian goods"?
- Sullivan: I have a suggestion there.
- H.M.Jr: Do you want to say "where it might drive prices up"?
- Shoup: Be clear what the meaning is. What we are fearing is a rising price. If it is, it ought to be left out.
- H.M.Jr: I am just thinking. "Would otherwise flood the market--"
- Sullivan: How is this, sir?
- H.M.Jr: It is the purchasing power. I mean, I just don't think - it is terms of money flooding the market.
- Shoup: It is not very clear.
- H.M.Jr: I mean, it is this excess money, extra money which is going to make this tremendous demand for the goods with the result that the prices will go up. I think if you don't mind - if you just put a question mark at that sentence.

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- Sullivan: I have a suggestion on that.
- H.M.Jr: Go ahead, John.
- Sullivan: "Both through taxation and through the sale of Defense Bonds we can and should absorb purchasing power which otherwise might contribute to inflation."
- H.M.Jr: Something along that line. It is all the same idea. Maybe that is the answer. I think if that sentence could be worked over. I mean, this is the first draft. Would you go ahead?
- Blough: "The Treasury recognizes its responsibility for assisting in the development of a fiscal policy that will prevent inflation."
- H.M.Jr: Just a moment, please. Instead of saying "recognizes", why not say "accepts"?
- Blough: "This aim can be achieved only if the proper proportion of total expenditures is raised by taxes and by the sale of bonds that draw in money which might otherwise force the price level up."
- Shoup: Purchasing power, perhaps, rather than money again?
- H.M.Jr: That is all right.
- Blough: "That proportion will change as our defense program proceeds. For the time being, I believe that we can continue along the lines that Secretary Morgenthau suggested when he appeared before you on this bill," or something like that.
- Gaston: "When he appeared before this Committee at the opening of the present hearings."

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Blough: "When he appeared before this Committee at the opening of the present hearings, that is, aim at raising approximately two thirds of the expenditures by taxation. At least this is so if the public responds by investing in Savings Bonds substantial sums of money that would otherwise have gone to swell the stream of non-essential expenditures. But at a later stage the proportion that we need to raise--"

H.M. Jr: Excuse me, Roy. Couldn't you say, "At least this is so if the Congress will pass this bill and if," and go on to the next thing?

Blough: And then get in also the idea that you mentioned a little while ago about not upsetting the apple cart.

"But at a later stage the proportion that we need to raise by taxation may well be higher. The Treasury is studying this problem and, as the defense program develops, will from time to time be prepared to suggest the proper proportions and the means of translating them into practice."

H.M. Jr: Now, does that mean, Mr. Sullivan, you are going to have another tax bill this year?

Sullivan: It might so be interpreted.

H.M. Jr: Well, do you think we ought to have that hedge?

Sullivan: Oh, I think if a need arises we don't need any hedge.

H.M. Jr: I think it is all right. I am just questioning it. O. K., Roy. The rest of that, do you mind?

Blough: Oh, no.

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"We cannot expect to devise a painless tax bill. The situation calls for sacrifices. As Secretary Morgenthau has already told you, we have had unmistakable evidence that the people are willing to make sacrifices according to their ability. Outside the tax field greater sacrifices are being asked and cheerfully made. There is no basis of comparison of the sacrifices of those who are asked to exchange the security of a job and a home for a soldier's pay and a soldier's hardships with the sacrifices of those who are asked to pay even drastically higher rates of tax."

- H.M.Jr: Elinor, is there any sour note in there?
Mrs.
Morgenthau: No, as far as I am able to understand it, it is very good.
- H.M.Jr: Anything that strikes you as sour?
Mrs.
Morgenthau: No.
- H.M.Jr: No false note?
Mrs.
Morgenthau: I like it.
- H.M.Jr: Think Walter Lippman can understand it?
(Laughter)
Mrs.
Morgenthau: If I understand it, isn't this practically what you expected to do in August or September when the bill was passed and you said - isn't this just a continuation of that?
- H.M.Jr: That is right.
- Now, what did the President say in his message?
- Kades: It is very short, Mr. Secretary, shall I read it?

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H.M.Jr: If you please.

Kades: "We are engaged in a great national effort to build up our national defenses to meet any and every potential attack. We are asking even our humblest citizens to contribute their might. It is our duty to see that the burden is equitably distributed according to ability to pay so that a few do not gain from the sacrifices of the many.

"I, therefore, recommend to the Congress the enactment of a steeply graduated excess profits tax to be applied to all individuals and all corporate organizations without discrimination."

That is the entire thing.

H.M.Jr: Well, I just raise the point, if we don't want to say - I mean, I am just raising it, simply say, "If we want to carry out the thought and the spirit of the President's message, we feel that not only that the present bill falls short of that, but the following suggestions we have in mind would come much nearer to carrying it out," something along that line.

What?

Sullivan: I don't think the message is sufficiently definite to help up by quoting it.

H.M.Jr: Think they might react against it?

Sullivan: I had a letter from Senator Vandenberg this week about excess profits tax on individuals. I called him up and explained the difficulties to him, and he said, "All right, don't bother to answer the letter," but this would refresh that whole problem, I think.

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H.M.Jr: Well, I am just raising it. What do you think, Mr. Knollenberg?

Knollenberg: I don't think it makes any difference one way or the other.

H.M.Jr: Do you think it strengthens the statement?

Knollenberg: No, unless it might make it more acceptable to the President, but as far as the public is concerned, I don't think it would.

H.M.Jr: No, maybe not.

Sullivan: It would be nice if we could insert in there the message that he sends down the morning I give the statement.

H.M.Jr: What do you mean?

Sullivan: I mean if he were to send down the new message Monday morning, that would be nice to have in there.

H.M.Jr: What do you think, Eddie?

Greenbaum: Since the President's statement was so general and wasn't directly pointed up to the Treasury program, which was more specific, I think it is just as well not to mention it, because here we are mentioning the Treasury program with these modifications.

H.M.Jr: Well, who has any suggestions they want to see go into this thing now?

Sullivan: I have one, sir, on page thirteen. There is a new paragraph in there. "Moreover, with this new broad excess profits tax base, it would be possible to adapt ourselves quickly and much more easily to a need for still larger revenues if the emergency should so require."

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That was my suggestion, and I think we have one added justification for this proposal that we haven't discussed up to now, and that is that we are living in a world in which things happen very fast and without very much advance notice, and if we need a lot of money in a hurry, we won't want to wait to take three or four months out to revise excess profits, and now, while we are working on our revenue bill, we very well might change this over so that if the need comes for a rapid expansion of our revenue, the machinery will all be there and we can take the time now, but we don't know whether we will be able to take that a year from now or six months from now.

- H.M.Jr: So you suggest what?
- Sullivan: Changing this now, going back to the Treasury plan so that if we then have to expand, we can do so merely by changing the rates.
- H.M.Jr: Who agrees with John?
- Foley: It is all right.
- H.M.Jr: You mean you would put that in there?
- Sullivan: Yes, I would, in amplification of this paragraph.
- Gaston: It is spelling out, isn't it John, that idea that is in there now?
- H.M.Jr: What do you think, Shoup?
- Shoup: I think it is a very good idea to emphasize the haste element and the possibility of having to hurry.
- H.M.Jr: O. K., Mr. Knollenberg.

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Knollenberg: I agree.

H.M.Jr: Eddie?

Greenbaum: If I understand it, I agree with it.

H.M.Jr: Well--

Greenbaum: More flexibility, you mean, John.

Sullivan: No, I mean the machinery will be there.

Greenbaum: You haven't said just what you would say.

Foley: He says if you switch from a war profits over to an excess profits, you have got the base established to raise much more revenue if the need arises, and all you have got to do is increase your rates.

Greenbaum: You are not suggesting changing this, you are suggesting adding that to it?

Sullivan: That is right, and why we are doing this at this time, although we are not in war. When we get in war, we won't have time to make the change, although I wouldn't want to say that.

H.M.Jr: Have you got anything else?

Sullivan: No, sir.

H.M.Jr: Is it satisfactory to you?

Sullivan: Yes, sir.

H.M.Jr: Herbert? Have you got any suggestions?

Gaston: I have nothing except a trifling thing in that insert, that latter part. I don't know what the page is. It is where it says, "This aim

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can be achieved only if the proper proportion of the expenditures." I think that sentence is a little difficult. I would suggest that "it can be achieved only if the proper proportion of total expenditures raised by taxes and if the sale of bonds draws in money which would otherwise be expended in such a way as to raise the price level."

Sullivan: How would it be, "And so long as the sale of bonds"? That removes the element of doubt.

Greenbaum: Is that sixteen, Herbert?

Blough: Fifteen, three-quarters of the way down.

Gaston: That is, I think, "the total expenditures raised by taxes and sale of bonds," you are really speaking about two proportions, if you do that.

Shoup: Of course it comes from--

Gaston: It creates a little confusion. You say, "If the proper proportion is raised by taxes and the sale of securities," of course the whole thing is going to be raised by--

Shoup: Well, we can rephrase that.

H.M.Jr: Anything else, Herbert:

Gaston: No, that is all.

H.M.Jr: Guy?

Helvering: Well, I just wanted to compliment them on their excellent expose of the other alternative plan.

H.M.Jr: You like it?

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Helvering: I think it is a marvelous statement.

H.M.Jr: But as to the whole thing?

Helvering: Oh, yes, to achieve the objective that we want to achieve.

H.M.Jr: Eddie?

Greenbaum: I want to join my voice in complimenting what I think is a remarkable piece of work. I still feel on page sixteen that doubt is cast upon the Savings Bond campaign. I think that language could be improved upon. At least this is so. "If the public responds by investing savings funds." My feeling is there if you go back to the other part where you are talking about the two thirds, you might say something to the effect that this is upon the assumption that the public will respond or some language which casts no doubt there. The same thought that John expressed before.

And then one other very minor thing, on page two, I don't like the use of the word "oppressive." "Any one tax, viewed by itself, may appear to be stringent and oppressive." I have no alternative word, but I think that ought to be replaced by some other word.

Sullivan: "Harsh"?

Greenbaum: "Harsh" is about the same as "oppressive."

Knollenberg: "Unfair"?

Greenbaum: "Stringent" alone would do it. I don't think there ought to be an admission that it appears oppressive.

H.M.Jr: Anything else, Eddie?

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Greenbaum: No.

H.M.Jr: Foley?

Foley: Well, I would like to see it end at page fifteen.

H.M.Jr: Where?

Foley: Page fifteen, at the end of the paragraph up at the top.

H.M.Jr: No. You mean you don't like that other stuff?

Greenbaum: Would you feel differently if that appeared in some other place?

Foley: No. I just don't - I would rather just advocate the old plan and stop. I kind of think it is like putting the Baptists and the Democrats together.

Greenbaum: I just had the feeling that that at the end there didn't belong right there. I like the idea, but I don't like it at that place.

H.M.Jr: Like sending Herbert Gaston up to New York to represent the Protestants.

Foley: That is right, Catholics. (Laughter)

Sullivan: We never had a report on that binge, either.

Foley: No, we will have to look into it.

H.M.Jr: Well, it is easy to drop it. Let's leave it the way it is. I personally - it happened to be my idea. I feel that way. I keep forgetting it is not my statement, but I think it is - it has been brought home to me so much here this week. I think we can do our part and we are doing our part, and we assume that

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responsibility, but somebody else has got to assume theirs. But let it cook over night, Ed.

Foley: I don't feel very strongly about it. I have more objection to the - to Guy's proposal than I do to the Savings Bond plug.

H.M.Jr: I think we have crossed that bridge this afternoon.

Foley: I won't make any point of it. I just prefer it the other way.

H.M.Jr: You mean you wouldn't have anything?

Foley: No, I would just end it with one proposal and make a plea for it and that is all.

H.M.Jr: Well, I think that this last part that you want could very well fit in somewhere else.

Greenbaum: That is why I asked Ed that, because it isn't another proposal.

H.M.Jr: It could be fitted in right at the beginning.

Blough: It is either at the very beginning or at the very end.

H.M.Jr: I think it might be better at the very beginning.

Shoup: Is this fifteen or sixteen?

Blough: This is the Savings Bond paragraph.

H.M.Jr: Well, it is more than that.

Blough: Well, I am identifying it in his mind that way.

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- Gaston: I shouldn't like to see it at the start, because I think it delays and confuses what you are talking about.
- Blough: We preferred it at the end for that reason, that having said your say, then you have a few additional comments to make of a general character.
- H.M.Jr: It struck me all right.
Chuck?
- Kades: Well, Mr. Secretary, I hesitate to dissent on the undistributed profits tax, but it seems to me that the Treasury can't go before the Ways and Means Committee and so lightly recommend an undistributed profits tax in such vague terms and without any supporting evidence at all. It is going to be a tremendous shock to everyone. It will come as a complete surprise, and it is done in a rather dainty fashion. If these principles aren't a guide--
- H.M.Jr: Dainty, did you say?
- Kades: We step lightly, as though we were on eggs, but we don't give them anything that is definite, tangible. We simply say, "If you want something that is easier, you might take the undistributed profits tax."
- Foley: I agree with him. I would like to end it at page thirteen. (Laughter)
- Kades: It seems to me we might say, "The excess profits tax is not the most equitable system. We can't have a really equitable system as long as we don't tap such a significant element of income as undivided profits. I think this committee ought to consider credit for distributions to stockholders as a permanent part of our tax

system, but that is a long-range alternative and that is not something for this emergency.

H.M.Jr: What do you think, Shoup?

Shoup: Well, I am rather inclined, as I think it over, to stop at page thirteen myself. That is, it is not terribly important to do so, but I am uneasy about getting ourselves tied up too specifically for any particular kind of undistributed profits tax approach yet.

H.M.Jr: You mean you wouldn't give any alternative?

Shoup: Well, that is a matter of broad policy which I find it a little difficult to know, not having been in the background of discussion in the past week or two, you see, but just coming to it fresh as a sort of layman on that subject. From the point of view of the way it looked to the public, I would say, why not just say what we want, and if they don't want it, let them take something else; but I hesitate to speak, Mr. Secretary, because I have not been in the discussions for the past week.

H.M.Jr: No, I feel this way, that down through the middle of page thirteen, it is a strong forthright statement, and we are hitting right straight from the shoulder. Then beginning the possible alternative, we are beginning to pussy-foot and there is no question it terrifically weakens the first part of the statement. The whole thing is in a different tone, and they can perfectly well say, the commentators, "Well, which does the Treasury want, and why don't they say what they want?"

Foley: That is right.

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- Shoup: We know what we want up to page thirteen. Beyond that we don't really know yet just what we want and we show it by the way we talk.
- H.M.Jr: That is right. It is partly because it has been done so recently. On the other hand, the thing that we were afraid of and I think the thing John is afraid of is that we go up there and say, "This is what we want," but that is such a slap in the face that they are going to say, "My God, the Treasury is just a lot of stubborn people, and they want what they - we have told them we don't want it."
- Foley: Times are different.
- Shoup: They will still think so, even with pages fourteen and fifteen.
- Sullivan: It takes a little of the curse off. We have already told them we would discuss three or four alternatives.
- Foley: That was because, John, we didn't know what we wanted. I think we have learned a lot since Monday.
- Sullivan: Well, that may be, but Chuck talks about how surprised they would be hearing about undistributed profits without any advance notice. They are going to be more surprised at our going back to this old plan than they would be about undistributed profits.
- Foley: I don't think Chuck is worried about the Committee, he is worried about the country.
- H.M.Jr: Well, it is an important decision. You are kind of putting it up to the President, which, in a sense, isn't fair. I like to give

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him something I believe in and let him change if he wants to, but it is sort of expecting him to decide this thing without any background. I have got the word that he wants it at ten, but he just wants the message the way I thought he would. He doesn't want anybody to come over.

Sullivan: Well, I am very definitely in favor of it.

H.M.Jr: I will bet you four to one that is the way he would take it, too.

Sullivan: I didn't hear the odds.

Shoup: Mr. Secretary, as long as the undistributed profits part is worded precisely the way it is now worded, I have the impression that the Treasury would be on safe ground, that it wouldn't ever have to go back on anything it was saying there, but I don't like to go beyond that in anything I say, and that does raise a question of whether you want that kind of a statement tacked on to the end of the other.

H.M.Jr: Well, Blough, let's just approach it - I mean Shoup, let's approach it this way a minute. If I may, let's get personal. Have you any doubts at all as to the soundness, as a tax economist, up and through page thirteen? I mean, do you think we are on grounds that we can defend ourselves on?

Shoup: Yes, I do. I think we can defend ourselves certainly through page thirteen. We can defend ourselves through page seventeen.

Greenbaum: I feel that the alternative should be put in because I feel with the Commissioner that if you stop at page thirteen without that, you

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are not being forthright in the very real administrative problems that confront you and in dealing with the excess profits tax. I think Mr. Foley and Mr. Kades are perfectly right that it is an important thing there and it should be made possibly a little clearer that that is not what the Treasury is advocating and that might be emphasized at the bottom of thirteen where you say, "If these principles are not to be the guide," by saying, "If, on the other hand, you do not accept these principles and you have asked us for another alternative, we are submitting this for your consideration if you reject our recommendations," or some language such as that, rather than putting this proposal as the Treasury proposal. Show that it is something that is submitted in response to an invitation and also at the same time it gives you the opportunity of registering the very real administrative difficulties that are necessarily implicit in the excess profits tax. I think it ought to be in there in some such wording.

H.M. Jr: Ferdie, if you were back at writing editorials on a paper and you had this to write an editorial about, what would you do about it?

Kuhn: I wouldn't write an editorial on taxes. (Laughter) I wouldn't dare. No, I would always be impressed with the fellow who came out with a hard-hitting, straight-shooting scheme which he outlined clearly and then defended sincerely and well, and I think that is why this is such a good statement. It does that very thing.

H.M. Jr: You would leave the whole thing as is?

Kuhn: Well, would it be possible to take page thirteen

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leaving out the alternative, and yet putting in some argument that is in here in behalf of your own scheme? That is, right down to the end of page thirteen, and then jump over to the Savings Bonds and the need of avoiding inflation.

H.M. Jr: No alternative schemes?

Kuhn: Well, I wouldn't say that it was necessary in the statement that you were presenting on this occasion. Isn't the Treasury being invited to come up to present its plan, its guidance?

H.M. Jr: No, what we were strictly invited to do was to come up, criticize the present tax bill and give them several alternative plans, and they would take the plans and work out the details. They didn't expect a perfected plan. That was the invitation.

Kuhn: Under those circumstances, then we ought to have some alternative too and make clear which one we prefer and why.

H.M. Jr: We are to give them several alternatives. He was very clear. He says, "You leave it to us to work out the details. We don't want you to come up and give a definite plan. That was the impression I got."

Gaston: There is another aspect of stating this alternative that I have that I haven't heard mentioned and that is what we are saying is that the present so-called excess profits is not a true excess profits, and "if you are not going to adopt some plan such as what we proposed a year ago, then you had better drop the excess profits idea altogether and not have a phoney excess profits." That is what that alternative

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says, in one phase of it, "that you had better drop the whole idea of excess profits if you are not going to have a thorough-going excess profits plan and go to something else, and here is something else."

H.M.Jr: And you think we ought to say that?

Gaston: I would be inclined to say we ought to leave it in.

H.M.Jr: Mr. Knollenberg?

Knollenberg: Well, I find it difficult to make up my mind on this. There is one element that I should like to know before attempting to swing the balance one way or the other in my mind and that is whether or not the Treasury plans at some time to advocate an undistributed profits tax. If it does, I think it would be valuable to get in a caveat at this time.

Gaston: That was one thing that was in my mind that I didn't say. I distinctly would like to see it, as Chuck Kades says. I think we inevitably must come to it for a long-range corporate tax plan.

Knollenberg: Well, as you probably know, I have been a very warm advocate of it ever since Oliphant first proposed it, but I think if we are not going to do that, if we don't have a rather immediate intention of doing that, that I would agree that it would be better to leave it out, not leave out pages fifteen and sixteen, which I think are excellent, but thirteen and fourteen.

If we do plan to do it, then I would like to see it stay in here as a sort of advance notice to which we could later refer back to and say,

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"This isn't something startling. We had already indicated that we thought this had merit at an earlier time." But to begin, probably call the heading, "Possible but not recommended alternatives," to give notice immediately and not wait until the last paragraph to indicate that we are not recommending this as a substitute, and then to--

H.M.Jr: That would help. "Possible but not recommended."

Knollenberg: It wouldn't be read out, probably, at the oral presentation but would be before them in that fashion.

And then begin on page fourteen, the fifth line, just with the simple statement. We have been so direct and concrete right straight through that I would like to continue that tone, and we would continue that tone if we began right in the midst of the sentence on page fourteen. "A simpler, more easily administered and more uniform plan would, of course, be to abandon the excess profits tax and to increase the corporate income tax by enough to produce the desired revenue."

H.M.Jr: Where would you say that?

Knollenberg: That would begin on page fourteen. Then we continue that simplicity of statement and directness and cut out all of this rather vague and offensive sounding language there and go right into that direct statement.

H.M.Jr: What do you think of that, Roy?

Blough: I think that would work out all right.

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- Sullivan: That is a good suggestion.
- H.M.Jr: I think that is good.
- Sullivan: On that heading, how would it be "Possible but not preferred alternatives"?
- Knollenberg: That is good.
- H.M.Jr: Yes. What?
- Knollenberg: Yes, I think that is all right.
- Foley: You see, Mr. Secretary, if you were going to make this statement, I wouldn't make the objection about pages fifteen and sixteen, but tacked on to this strictly tax statement--
- H.M.Jr: I think you are right. It is going through my mind. This will be safe for another time. I think that is right.
- Sullivan: Yes, I wondered about that myself.
- H.M.Jr: I get confused.
- Knollenberg: I would like to attack that proposed change in the heading and leave it stand because, as I read it now, you get to this saving clause at the end so quickly now that I don't think you need to change the heading.
- H.M.Jr: Let's agree on this, that we will leave the Savings Bond and price stuff out for Morgenthau to say sometime. We are sort of tending to leaving the other stuff in. What are you going to do about Chuck Kades feeling we are just kind of slipping them something on the undistributed profits tax? Have these recent suggestions at all taken care of what you had in mind, Chuck?

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- Kades: I think what Mr. Knollenberg has in mind is pretty much the same thing as I was trying to express.
- H.M.Jr: Do you think this would sort of take care of it, his suggestions?
- Kades: Yes, sir.
- H.M.Jr: I think we will leave out the prices and Savings Bonds and so forth and so on. Mrs. Morgenthau can use that on the quiz hour when she goes on. (Facetiously)
- Kuhn: And yet, isn't that going to lay this whole statement open to attack on the ground that it doesn't show any conception of the needs of defense controlling inflation? The shouting is going on in the papers.
- H.M.Jr: True, but Professor Sullivan is going up to talk about excess profits. He is not going up to talk about prices.
- Foley: That is only a phase of this whole tax program. This is John's second appearance and--
- H.M.Jr: Whose side are you on?
- Foley: I am on your side.
- H.M.Jr: Go ahead then. (Laughter)
- Foley: I am talking against Ferdie. But I still say that if it were the Secretary's comprehensive statement, I think it has a part in it, but I don't think that the charge that you make can be leveled against John when he is talking about excess profits, and he has addressed himself only to that part of the subject.
- H.M.Jr: John says that I can use that part in my

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statement before the Senate Finance Committee.

Foley: Sure, that is all right.

H.M.Jr: I mean, that is John's suggestion.

Now, how far did I get? I got to Foley. I got to Kades. Did I get to you, Ferdie?

Kuhn: Well, I had only two or three very minor--

H.M.Jr: Excuse me, were you through, Chuck?

Kades: Mr. Secretary, if I may make one more point--

H.M.Jr: That is what you are here for.

Kades: I am a little bit disturbed about the undistributed profits tax still, although I like Mr. Knollenberg's suggestion, because the whole emphasis on the - in the rest of the statement is on savings. Now, one of the principle purposes--

H.M.Jr: That is out.

Kades: But the undistributed profits tax, the principle purpose of the undistributed profits tax is to tax corporate savings, and even if you leave out the Savings Bond portion of it, it seems to me that you are in the position of advocating spending rather than saving, which is contrary to the gist of our other tax proposals.

Sullivan: No, it isn't. It is forcing the corporations to pay out in dividends so that we can clip them with the individual surtax rates.

Kades: If you had a full penalty undistributed profits

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tax, that would be so, John, but that is not what this proposal is. This proposal is that an undistributed profits surtax on top of a normal corporate surtax. There isn't going to be much room after a corporation pays a thirty percent corporate tax.

H.M.Jr: Chuck, you are getting beyond my depths, and if Blough can take it after I go home, would you mind talking with him about it? I mean, will you? I mean, I am not trying to shut you off. You are getting into a very technical thing, and I am awfully tired, but if Blough has still got anything left in him--

Blough: I think we have met his point, but I will be very glad to talk to him about it.

Kades: Well, I just wanted to raise the point.

Sullivan: I have just one thing. Page thirteen, the "Possible alternatives." You end the first and third sentences exactly the same way. You put those principles into operation, see.

Blough: Yes.

Sullivan: And you end the third sentence with "putting the principles into practical operation."

H.M.Jr: Ferdie?

Kuhn: Just a couple of little things I can talk to Roy about.

H.M.Jr: All right.

Shoup: I have had my say already.

H.M.Jr: Roy, do you want to discuss Roy Blough?

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Blough: No, I want to say that you don't need to blame this all on me, that Shoup helped all afternoon, and a lot of this is Gaston and Magill and Sullivan and other people, and we have just tried to work it in.

Knollenberg: I had one more suggestion, a minor one, but it is again standing in the shoes of what I think is the typical businessman and his reaction, and that is a statement on page five which I would like to read for your consideration. It is the statement - it is the sixth line on page five. "These profits represent in large part money taken from consumers in excess of the amount necessary to produce the goods or services."

Now, if I were reading that and had not had the explanation of Mr. Shoup this afternoon, I should have thought that that meant that the Treasury was indicating that it thought all profits were, in a sense, improper. Now, Mr. Shoup explained that an economist takes into account that a normal return on the capital represents part of the necessary expense to produce goods, but I don't think the average businessman would appreciate that, and I, therefore, would like to have that sentence cut out.

H.M.Jr: It is all right with me. I don't think it is sufficiently important to leave it in. It is again the consumer price thing, and I am perfectly willing to leave it out.

Anything else?

Knollenberg: No.

H.M.Jr: Well, I will tell you, Roy. I don't know whether you can do this, physically. I wish

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you would answer it. My aim is to get it in the President's hands by ten.

- Blough: It will be in your hands by a quarter of ten, if you wish it.
- H.M.Jr: I would like to have it in my hands by nine so that I could read it once, you see.
- Foley: What is your trouble, stenographic trouble, Roy?
- Blough: That is the only trouble. I think I can handle that.
- Foley: Well, we have a girl here at eight o'clock.
- Blough: Do you have a pica typewriter?
- Foley: Yes.
- Blough: All right, fine. If I can use your girl.
- H.M.Jr: Well, now, who will want to see it at nine?
- Sullivan: I will. I would like to see it.
- H.M.Jr: Well, anybody that is here, that can make it.
- Knollenberg: I should like to see it if I can get admission down here at nine, before nine if possible.
- H.M.Jr: Yes. Well, let's put it this way. I would like you all to be here at nine if you can make it. Think you can make it, Ed?
- Foley: Sure.
- Gaston: I often get down here by nine o'clock.
- H.M.Jr: Well, we will all be here at nine, then, except you (Blough)

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Blough: I will be here at nine unless you don't care
to have me here.

H.M.Jr: Can't get along without you.

Blough: Then I will be here at nine.

H.M.Jr: All right. Ever so much obliged to everybody.

Treasury Statement on
DRAFT OF [^] EXCESS PROFITS TAX ~~CHANGEMENT~~

My purpose today is to discuss with you the problem of corporate taxation in the present emergency. What I shall have to say is supplementary to the statement made by Secretary Morgenthau when the current hearings were opened and ^{to} the suggestions laid before you subsequently on behalf of the Treasury Department.

The Treasury is called upon to meet expenditures greater than have ever been made in the nation's peacetime history, and probably greater than at any period in our history, in peace or war. At such a time we cannot expect to rely on normal sources of revenue or be content with revenue in normal amounts. We must adopt extraordinary measures to deal with our extraordinary situation.

Your Committee is now formulating changes in our tax system, both to provide the revenues needed to finance the defense expenditures that we are committed to make, and also to assist in maintaining the economic health of the nation. Our people know that we are faced with a great challenge. They know that great sacrifices must be made and they are prepared

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to make them. They rely upon us so to plan our financial program that, however severe its burdens may have to be, they will rest fairly and justly upon all individuals and all businesses.

The tax program which you will propose will necessarily consist of many elements. Any one tax, viewed by itself, may appear to be stringent, and ~~unpopular~~. All must be viewed, however, as parts of a whole. This is an emergency. Taxes that would not be proposed in peace times are a necessity now. We cannot give effect to all these niceties of exemptions and saving clauses that are appropriate to easier occasions but today will defeat our ends.

I have been asked particularly to discuss the excess profits tax, first enacted in the fall of 1940. Our experience with it is still limited, for many of the returns of the largest corporations have not yet been filed. Enough have been filed, however, to convince Treasury officials in charge of administration that important changes in the law must be made in the interests of fairness. We are collecting large sums by

- 3 -

means of this tax, but the profits of a good many business firms are not being touched by the tax, although these profits ^{are} ~~appear~~ excess profits by any *reasonable* standards ~~that seem reasonable~~. There is certainly a place to broaden the base. Surely the skill of this Committee and its experts is adequate to the task of bringing within the tax the known cases of corporate excess profits.

I want first to outline the principles which I believe should govern the taxation of excess profits; second, to indicate respects in which the present law fails to accord with these principles; and third, to suggest possible remedies which the Congress may wish to consider.

I - Principles

Under present conditions some kinds of profits may be appropriately subjected to heavier taxation than other kinds. This may be necessary in order to distribute the burden fairly and to avoid unfavorable economic effects that might result if the revenue were raised in other ways.

1. Defense profits

The first type of profits which should, in a period of this kind, be subjected to special taxation comprise the profits which may be reasonably

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attributed to the defense program. Such profits are being made out of the sacrifices of the people as a whole and should be returned to the people in taxes, insofar as may be possible without destroying necessary incentives to produce defense goods.

In ~~many~~^{many} cases it is not possible to distinguish with precision the additional profits due to the defense program. The effects of defense spending are diffused throughout the whole economic system. It is necessary, accordingly, to assume that in general, increases in profits during this period are due to defense. ~~Some vested interest should be protected since it is clear that this is not the case.~~ Inability to measure defense profits precisely should not discourage us from subjecting them to special taxation even at the risk of hitting some income ~~not~~^{derived from} the defense program.

2. Profits in excess of a necessary ^{normal} return on invested capital.

The other kind of profit ~~is~~^{comprises} that can properly be subjected to special taxation ~~is~~^{is} profits in excess of a necessary normal return on invested capital,

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even if this return was being earned in the years prior to the defense program. The existence of such profits, while often due primarily to good management, ^{is} also in numerous cases due to monopoly, imperfect competition, or fortunate circumstances, and not to any outstanding service to the public. ~~These profits~~

~~represent in large part money taken from consumers in excess of the cost of the goods or~~

services. When the imperfections of our economic machine have permitted this to happen, it is equitable and desirable that the excess profits be subjected to special taxation. Furthermore, at a time when heavy taxes must be imposed they should be levied where they will assist best in maintaining a well-functioning economy. To take an especially large share of the profits in excess of a normal return on invested capital will not cause any companies to go into bankruptcy or withdraw from business.

I am aware that the anticipation of extraordinarily large profits may in many cases have put security prices well above a figure that would represent invested capital. The imposition of these special taxes may seem harsh to individuals who have purchased these

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securities at such levels. We cannot entirely disregard this aspect of the problem, but we must remember that no legislation is ever passed and no progressive step is ever taken which does not disturb the established interests of some people. We submit that established expectations of high profits are entitled to no more protection than an individual's expectation of a continued large salary, now subject to a heavy tax. This is an emergency and changes must be expected.

I am also aware that the application of the principle of taxing profits in excess of a necessary normal return on capital involves difficulties of both principle and technique. *These difficulties should not be underestimated, but* I feel sure that we should not allow ~~these difficulties~~ ^{them} to stand in the way of our seeking to attain the main objective.

II - Defects of the present law

In the light of the principles just stated, let us now examine the excess profits tax law passed last year, to see in what respects, if any, it fails to correspond to them.

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1. Failure to reach large parts of defense profits

The Excess Profits Tax Act of 1940 was a clear expression of Congressional intent that profits growing out of the defense effort should be subject to excess profits tax. The law, however, has not achieved that objective. Many corporations that are the principal beneficiaries of the defense effort and that hold large government contracts are paying little or no excess profits tax.

In the absence of complete excess profits tax returns an examination has been made of published financial data for certain corporations. One company whose profits in 1940 were more than 3,000 percent larger than in 1939 is subject to no excess profits tax whatever on 1940 earnings and this is a company which has thus far received over \$70 million of defense contracts. A large steel company which has received over \$250 million of defense contracts and had earnings in 1940 of nearly 200 percent larger than in 1939 will pay no excess profits tax. It appears that only 5 out of 12 large integrated steel companies will be subject to excess profits tax on the income of 1940, although steel companies have in general received huge amounts

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of defense orders.

These companies pay little or no excess profits tax because they are allowed a minimum credit of 5 percent of invested capital.

2. Failure to tax profits in excess of a necessary normal return

Another serious shortcoming of the 1940 excess profits tax law is that profits in excess of a necessary normal return on invested capital are not subjected to the tax unless such profits also represent an increase over the profits of the base period. For example, one company which earned during the base period an average of approximately 40 percent on its present invested capital will be free from the excess profits tax on income in any year equal to approximately this 40 percent and will be taxable only on such increases in income as it may enjoy.

This failure of the law to reach a large portion of excess profits ^{is} due to the provision of a credit for every corporation equal to 95 percent of its base period earnings, regardless of the size of these earnings in relation to its invested capital.

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III - Remedies

Revisions of the excess profits tax to be considered adequate, must reach the two kinds of profits which I have been discussing. The tax can reach a much larger proportion of defense profits ^{if there is a reduction} ~~by reducing~~ the 5 percent credit on invested capital. Profits in excess of a necessary normal return can be reached by taxing all profits above a stated percentage of invested capital, regardless of average base period earnings.

These were the basic elements of the Treasury excess profits tax proposal of 1940, and it is this plan, with modifications dictated by experience, that we suggest. In that proposal corporations were to be allowed, tax free, their earnings during the base period, but not more than 10 percent of invested capital. However, they ^{were} granted a minimum credit of 4 percent of invested capital with 6 percent allowed on the first \$500,000. Thus, under the ~~Treasury~~ ^{that} plan a concern which earned 7 percent during the base period would be allowed to continue to earn 7 percent free of tax. A concern which earned only 2 percent during the base period would

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be permitted to earn 4 percent free of tax. A concern which earned 15 percent during the base period would be allowed to earn 10 percent free of tax.

Under the ¹⁹⁴⁰ Treasury proposal it was recognized that if businesses were to be expanded and investors were to put money into new corporations, an opportunity must be allowed to earn a substantial rate of return on new capital. The plan allowed an 8 percent return, regardless of the earning experience during the base period on old capital.

If the ~~Summary~~ ^{submitted by the Treasury last year} plan had been applied in the examples previously presented, the tax results would have been quite different. The corporation which had the 40 percent return on its invested capital in the base period would have paid excess profits tax on about half of its ¹⁹⁴⁰ income instead of on about one-twentieth ^{as} under the present law. ~~The large steel company~~ ^{one of the large companies} ~~would have paid excess profits tax on~~ ^{that received over \$25,000,000 in 1940} over one-third of its income and the other company with poor earnings in the base period would have paid on about one-fifth of its income instead of both ^{companies} being entirely exempt.

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Even this plan, however, would have failed to reach substantial amounts of defense profits received by corporations which had especially poor earnings during the base period. To meet this defect we would suggest revising the 1940 proposal to provide that where the average earnings of the base period were less than the minimum of 4 percent, the excess profits tax should be applied at a low flat rate, possibly 10 percent, to that part of the current profits that is in excess of the base period earnings but not in excess of 4 percent of invested capital. For example, if a corporation earned during the base period an average of \$100,000 a year, while 4 percent of its invested capital amounts to \$300,000, the first \$100,000 of profits in the current taxable year would be entirely exempt from excess profits tax, the next \$200,000, representing the difference between the \$100,000 average earnings and the \$300,000 credit on invested capital, would be taxed at 10 percent and any earnings over \$300,000 would be subject to the regular excess profits tax rates. This special rate of tax would subject all increases in profits during the defense period at least

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to some excess profits taxation while at the same time not being high enough to impose an undue burden on concerns whose increased earnings are not truly defence profits.

We would suggest also that the rate allowed on new capital be the same as the maximum rate allowed on old capital, namely, 10 percent. Any maximum return on capital must be a somewhat arbitrary figure because businesses differ widely in the degree of risk they face. Accordingly, it is desirable not to set too low a maximum rate of return.

Similarly, it would be desirable to keep the tax rate low on that part of the profit which is immediately above the credit. To this end we suggest that tax rates be graduated in accordance with the rate of return ~~on~~ invested capital with a moderate initial rate. It should be possible to raise the desired revenue with a lower rate scale on the average than under the present law because of the larger amount of profits that will be subject to tax.^x

The future is especially uncertain during an emergency period and we might have to act quickly.

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Moreover, with this new broad excess profits base, it would be possible to adapt ourselves quickly and much more easily to a need for still larger revenues if the emergency should so require. It is ~~far~~ better to have ^{a broad excess profits tax base carefully worked out} such an instrument ~~at hand~~ than to patch up the present law only perhaps to find ourselves confronted with the necessity of improvising ^{such a base on short notice} ~~a broader base~~ at a later date.

while we still have the time

^{but not preferred}
IV. Possible alternative

Thus far I have outlined what seem to me to be the principles of excess profits taxation that should be followed in this emergency period and have indicated ways in which the existing law fails to ^{carry these out} ~~put these principles into operation~~. If you believe with me in these principles, I believe you will agree that a plan similar to the one I have outlined is the logical method of putting the principles into practical operation. Variation in details is not a matter of concern, so long as the plan adopted fulfills the clear purpose to impose taxes both on defense profits and on excess profits, which is something the present law does not do.

If these principles are not to be the guide for taxing corporations ^{during} ~~under~~ the ^{emergency period} ~~defense program~~, it

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it might be well to
~~seems to me that you should~~ consider carefully the
 disadvantages of having a tax which involves the
~~extra administration~~ ^{the difficulties} of the present tax, but applies
 only to part of the profits that it should reach.

~~It may well be that to substitute~~ a simpler, more
 easily administered ~~and more effective~~ plan would be
 to abandon the excess profits tax and to increase
 the corporation income tax by enough to produce the
 desired revenue. ^{With} such an increase in corporation

income tax ^{there is, in my judgment,} ~~it is~~ ^{the} ~~essential~~ ^{to include a provision}
~~for reducing the tax by having~~
~~integral part of the plan, relief from the tax~~

~~to the extent that~~ the earnings of the corporation are
~~made~~ ^{made} ^{immediately} subject to the individual
 income tax, ^{either through} by the distribution of dividends or in some

~~other way.~~

^{This kind of}
~~such~~ a plan would be in harmony with the idea
 of integrating the corporation and the individual
 taxes, placing chief reliance on the taxation of
 income to individuals. With our experience with
 previous plans of this general character, many
 difficulties previously met can very likely be
 avoided and equitable taxation of profits to the
 individual stockholder provided.

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I do not set forth this plan as one that carries into effect the principles which I previously discussed. It is based on principles of its own and is suggested as an alternative, not a substitute.

~~The revenue measures you are considering is part of a broad plan not only to spread the burden fairly but also to prevent the price level from rising unduly. The sale of Defense Savings Bonds is another part of that plan. Both taxation and Defense Bonds can absorb money that would otherwise flood the market for civilian goods where it might drive prices up. The Treasury ^{accepts} ~~recognizes~~ its responsibility for assisting in the development of a fiscal policy that will prevent inflation. This aim can be achieved only if the proper proportion of total expenditures is raised by taxes and ^{would} ~~by~~ the sale of bonds that draw in money which might otherwise force the price level up. That proportion will change as our defense program proceeds. For the time being, I believe that we can continue along the lines that ^{Secy Worgenthal} ~~I~~ suggested when I appeared before you at the Hearings on the Public Debt Act of 1941 - that is, aim at raising approximately two-thirds of the expenditures by taxation on a full fiscal~~

*Comp will pay
the bill*

*We can't
just take an
amount that
will be
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of your
policy
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of your
Wells*

- 16 -

year basis. At least this is so if the public responds by investing in Savings Bonds substantial sums of money that would otherwise have gone to swell the stream of non-essential expenditures. But at a later stage the proportion that we need to raise by taxation ^{may well} be higher. The Treasury is studying this problem and, as the defense program develops, will from time to time be prepared to suggest the proper proportions and the means of translating them into practice.

We cannot expect to devise a painless tax bill. The situation calls for sacrifices. As Secretary Morgenthau has already told you, we have had unmistakable evidence that the people are willing to make sacrifices according to their ability. ~~It seems to us permissible to point ourselves again that~~ Outside the tax field greater sacrifices are being asked and ^{cheerfully made} ~~must be asked~~. There is no basis of comparison of the sacrifice of those who are asked to exchange the security of a job and a home for a soldier's pay and a soldier's hardships with the sacrifice of those who are asked to pay even drastically higher rates of tax.

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From Roy Blough
May 15, 1941
10.15 A.M.

EXCESS PROFITS TAX STATEMENT

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Chapter I - Principles

In this emergency period the following profits should be subjected to special taxation:

(1) Increases in profits above the level of recent years (average 1936-1939) reasonably attributable directly or indirectly to the increased spending of the defense program.

(2) Profits in excess of a reasonable percentage (perhaps 10 or 12 percent) of the invested capital of a corporation, whether or not such profits constitute an increase over the profits of the base period.

(a) This principle is accepted despite inequities which may result to individual stockholders.

Chapter II - Defects of the present law

(1) The minimum credit of 8 percent of invested capital exempts in whole or in large part the profits of many corporations derived from the defense program.

(2) The lack of a maximum rate of return on capital which corporations are permitted to earn free of tax exempts profits in excess of a reasonable percentage if such profits were earned also during the base period.

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Chapter III - Remedies

(1) The first defect may be remedied, at least in part, by reducing the minimum exemption below 8 percent, either through

- (a) Reducing the percent of credits, or
- (b) Disallowing the normal tax as a deduction in computing excess profits.

(2) The second defect can be remedied by placing an upper limit on profits which can be earned free from tax.

(3) The original Treasury proposal contained both of these remedies.

(4) The provision of a maximum return on invested capital involves great difficulties in defining and measuring invested capital equitably.

Roy Blough
May 15, 1941

DRAFT OF EXCESS PROFITS TAX STATEMENT

10.30
P.M.

My purpose today is to discuss with you the problem of corporate taxation in the present emergency. What I shall have to say is supplementary to the statement made by Secretary Morgenthau when the current hearings were opened and the suggestions laid before you subsequently on behalf of the Treasury Department.

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to make them. They rely upon us so to plan our financial program that, however severe its burdens may have to be, they will rest fairly and justly upon all individuals and all businesses.

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- 3 -

means of this tax, but the profits of a good many business firms are not being touched by the tax, although those profits appear ^{to be} excess profits by any standards that seem reasonable. Here is certainly a place to broaden the base. Surely the skill of this Committee and its experts is adequate to the task of bringing within the tax the known cases of corporate excess profits.

I want first to outline the principles which I believe should govern the taxation of excess profits; second, to indicate respects in which the present law fails to accord with those principles; and third, to suggest possible remedies which the Congress may wish to consider.

I - Principles

Under present conditions some kinds of profits may be appropriately subjected to heavier taxation than other kinds. This may be necessary in order to distribute the burden fairly and to avoid unfavorable economic effects that might result if the revenue were raised in other ways.

1. Defense profits

The first type of profits which should, in a period of this kind, be subjected to special taxation comprises the profits which may be reasonably

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attributed to the defense program. Such profits are being made out of the sacrifices of the people as a whole and should be returned to the people in taxes, insofar as may be possible without destroying necessary incentives to produce defense goods.

In a majority of cases it is not possible to distinguish with precision the additional profits due to the defense program. The effects of defense spending are diffused throughout the whole economic system. It is necessary, accordingly, to assume that in general, increases in profits during this period are due to defense. Some relief can and should be granted where it is clear that this is not the case. Inability to measure defense profits precisely should not discourage us from subjecting them to special taxation even at the risk of hitting some incomes not due to the defense program.

2. Profits in excess of a necessary return on invested capital

The other kind of profits that can properly be subjected to special taxation are profits in excess of a necessary normal return on invested capital,

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even if this return was being earned in the years prior to the defense program. The existence of such profits, while often due primarily to good management, are in numerous cases due to monopoly, imperfect competition, or fortunate circumstances, and not to any outstanding service to the public. These profits represent in large part money taken from consumers in excess of the amount necessary to produce the goods or services. When the imperfections of our economic machine have permitted this to happen, it is equitable and desirable that the excess profits be subjected to special taxation. Furthermore, at a time when heavy taxes must be imposed they should be levied where they will assist best in maintaining a well-functioning economy. To take an especially large share of the profits in excess of a normal return on invested capital will not cause any companies to go into bankruptcy or withdraw from business.

I am aware that the anticipation of extraordinarily large profits may in many cases have put security prices well above a figure that would represent invested capital. The imposition of these special taxes may seem harsh to individuals who have purchased those

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securities at such levels. We cannot entirely disregard this aspect of the problem, but we must remember that no legislation is ever passed and no progressive step is ever taken which does not disturb the established interests of some people. We submit that established expectations of high profits are entitled to no more protection than an individual's expectation of a continued large salary, now subject to a heavy tax. This is an emergency and changes must be expected.

I am also aware that the application of the principle of taxing profits in excess of a necessary normal return on capital involves difficulties of both principle and technique. I feel sure that we should not allow these difficulties to stand in the way of our seeking to attain the main objective.

II - Defects of the present law

In the light of the principles just stated, let us now examine the excess profits tax law passed last year, to see in what respects, if any, it fails to correspond to them.

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1. Failure to reach large parts of defense profits

The Excess Profits Tax Act of 1940 was a clear expression of Congressional intent that profits growing out of the defense effort should be subject to excess profits tax. The law, however, has not achieved that objective. Many corporations that are the principal beneficiaries of the defense effort and that hold large government contracts are paying little or no excess profits tax.

In the absence of complete excess profits tax returns an examination has been made of published financial data for certain corporations. One company whose profits in 1940 were more than 3,000 percent larger than in 1939 is subject to no excess profits tax whatever on 1940 earnings and this is a company which has thus far received over \$70 million of defense contracts. A large steel company which has received over \$250 million of defense contracts and had earnings in 1940 of nearly 200 percent larger than in 1939 will pay no excess profits tax. It appears that only 5 out of 12 large integrated steel companies will be subject to excess profits tax on the income of 1940, although steel companies have in general received huge amounts

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of defense orders.

These companies pay little or no excess profits tax because they are allowed a minimum credit of 8 percent of invested capital.

2. Failure to tax profits in excess of a necessary normal return

Another serious shortcoming of the 1940 excess profits tax law is that profits in excess of a necessary normal return on invested capital are not subjected to the tax unless such profits also represent an increase over the profits of the base period. For example, one company which earned during the base period an average of approximately 40 percent on its present invested capital will be free from the excess profits tax on income in any year equal to approximately this 40 percent and will be taxable only on such increases in income as it may enjoy.

This failure of the law to reach a large portion of excess profits was due to the provision of a credit for every corporation equal to 95 percent of its base period earnings, regardless of the size of those earnings in relation to its invested capital.

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III - Remedies

Revisions of the excess profits tax to be considered adequate, must reach the two kinds of profits which I have been discussing. The tax can reach a much larger proportion of defense profits by reducing the 8 percent credit on invested capital. Profits in excess of a necessary normal return can be reached by taxing all profits above a stated percentage of invested capital, regardless of average base period earnings.

These were the basic elements of the Treasury excess profits tax proposal of 1940, and it is this plan, with modifications dictated by experience, that we suggest. In that proposal corporations were to be allowed tax free their earnings during the base period, but not more than 10 percent of invested capital. However, they granted a minimum credit of 4 percent of invested capital with 6 percent allowed on the first \$500,000. Thus, under the Treasury plan a concern which earned 7 percent during the base period would be allowed to continue to earn 7 percent free of tax. A concern which earned only 2 percent during the base period would

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be permitted to earn 4 percent free of tax. A concern which earned 15 percent during the base period would be allowed to earn 10 percent free of tax.

Under the Treasury proposal it was recognized that if businesses were to be expanded and investors were to put money into new corporations, an opportunity must be allowed to earn a substantial rate of return on new capital. The plan allowed an 8 percent return, regardless of the earning experience during the base period on old capital.

If the Treasury plan had been applied in the examples previously presented, the tax results would have been quite different. The corporation which had the 40 percent return on its invested capital in the base period would have paid excess profits tax on about half of its income instead of on about one-twentieth under the present law. The large steel company would have paid excess profits tax on over one-third of its income and the other company with poor earnings in the base period would have paid on about one-fifth of its income instead of both being entirely exempt.

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Even this plan, however, would have failed to reach substantial amounts of defense profits received by corporations which had especially poor earnings during the base period. To meet this defect we would suggest revising the 1940 proposal to provide that where the average earnings of the base period were less than the minimum of 4 percent, the excess profits tax should be applied at a low flat rate, possibly 10 percent, to that part of the current profits that is in excess of the base period earnings but not in excess of 4 percent of invested capital. For example, if a corporation earned during the base period an average of \$100,000 a year, while 4 percent of its invested capital amounts to \$300,000, the first \$100,000 of profits in the current taxable year would be entirely exempt from excess profits tax, the next \$200,000, representing the difference between the \$100,000 average earnings and the \$300,000 credit on invested capital, would be taxed at 10 percent and any earnings over \$300,000 would be subject to the regular excess profits tax rates. This special rate of tax would subject all increases in profits during the defense period at least

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to some excess profits taxation while at the same time not being high enough to impose an undue burden on concerns whose increased earnings are not truly defense profits.

We would suggest also that the rate allowed on new capital be the same as the maximum rate allowed on old capital, namely, 10 percent. Any maximum return on capital must be a somewhat arbitrary figure because businesses differ widely in the degree of risk they face. Accordingly, it is desirable not to set too low a maximum rate of return.

Similarly, it would be desirable to keep the tax rate low on that part of the profit which is immediately above the credit. To this end we suggest that tax rates be graduated in accordance with the rate of return on invested capital with a moderate initial rate. It should be possible to raise the desired revenue with a lower rate scale on the average than under the present law because of the larger amount of profits that will be subject to tax.

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Moreover, with this new broad excess profits base, it would be possible to adapt ourselves quickly and much more easily to a need for still larger revenues if the emergency should so require. It is far better to have such an instrument at hand than to patch up the present law only perhaps to find ourselves confronted with the necessity of improvising a broader base at a later date.

IV. Possible alternative

Thus far I have outlined what seem to me to be the principles of excess profits taxation that should be followed in this emergency period and have indicated ways in which the existing law fails to put those principles into operation. If you believe with me in these principles, I believe you will agree that a plan similar to the one I have outlined is the logical method of putting the principles into practical operation. Variation in details is not a matter of concern, so long as the plan adopted fulfills the clear purpose to impose taxes both on defense profits and on excess profits, which is something the present law does not do.

If these principles are not to be the guide for taxing corporations under the defense program, it

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seems to me that you should consider carefully the disadvantages of having a tax which involves the extra administration of the present tax, but applies only to part of the profits that it should reach. It may well be that in such case a simpler, more easily administered and more uniform plan would be to abandon the excess profits tax and to increase the corporation income tax by enough to produce the desired revenue. Such an increase in corporation income tax should, in my judgment, have as an integral part of the plan, relief from the tax to the extent that the earnings of the corporation are immediately made subject to the individual income tax, by the distribution of dividends or in any other way.

Such a plan would be in harmony with the idea of integrating the corporation and the individual taxes, placing chief reliance on the taxation of income to individuals. With our experience with previous plans of this general character, many difficulties previously met can very likely be avoided and equitable taxation of profits to the individual stockholder provided.

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I do not set forth this plan as one that carries into effect the principles which I previously discussed. It is based on principles of its own and is suggested as an alternative, not a substitute.

The revenue measure you are considering is part of a broad plan not only to spread the burden fairly but also to prevent the price level from rising unduly. The sale of Defense Savings Bonds is another part of that plan. Both taxation and Defense Bonds can absorb money that would otherwise flood the market for civilian goods where it might drive prices up. The Treasury recognizes its responsibility for assisting in the development of a fiscal policy that will prevent inflation. This aim can be achieved only if the proper proportion of total expenditures is raised by taxes and by the sale of bonds that draw in money which might otherwise force the price level up. That proportion will change as our defense program proceeds. For the time being, I believe that we can continue along the lines that I suggested when I appeared before you at the Hearings on the Public Debt Act of 1941 - that is, aim at raising approximately two-thirds of the expenditures by taxation on a full fiscal

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year basis. At least this is so if the public responds by investing in Savings Bonds substantial sums of money that would otherwise have gone to swell the stream of non-essential expenditures. But at a later stage the proportion that we need to raise by taxation will be higher. The Treasury is studying this problem and, as the defense program develops, will from time to time be prepared to suggest the proper proportions and the means of translating them into practice.

We cannot expect to devise a painless tax bill. The situation calls for sacrifices. As Secretary Morgenthau has already told you, we have had unmistakable evidence that the people are willing to make sacrifices according to their ability. It seems to me permissible to remind ourselves again that outside the tax field greater sacrifices are being asked and must be asked. There is no basis of comparison of the sacrifice of those who are asked to exchange the security of a job and a home for a soldier's pay and a soldier's hardships with the sacrifice of those who are asked to pay even drastically higher rates of tax.

May 15, 1941
11:00 a.m.

RE TAXES

Present: Mr. Gaston
Mr. Magill
Mr. Sullivan
Mr. Greenbaum
Mr. Blough
Mr. Knollenberg
Mr. Kades
Mr. Foley

H.M. Jr: Well, I appreciate this outside help. We are in a spot where we need it badly. What we are trying to do here is this, and this is what my understanding is with the leaders in the House and in the Senate. They are perfectly agreeable that the - that Sullivan come up there and point out the defects in the present excess profits law. They also invite him to make suggestions on how the thing can be changed, and they, fortunately for us, are reserving the right as to how to work it out, which makes it perfect.

What we have attempted to do here since I sent out an SOS was to get this thing down into three categories, really four. We started with the history. We will give you a memorandum which was prepared last summer by one Magill, one Randolph Paul, one Sullivan and Foley, which we gave to the

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President setting down the principles that we were trying to get and really, from that day to this, we have never discussed it with the President.

Then we started ahead and wrote the bill. Now, we thought - what I have got to do is - I mean, I asked the President whether he cared to see it. He does. Mr. Doughton has been a perfectly swell sport. Instead of saying we weren't ready, he has announced that he would give the out-of-town witnesses a chance to testify tomorrow and hold us over until Monday, so there has been no leaks, and he has been perfectly swell about it, which took me off a very embarrassing spot, not to say Sullivan's embarrassment.

So what I am trying to do is, if it is mentally and physically possible, to get something to the President tomorrow, because he has been ready since yesterday to receive it, and it is our fault and not his, and I think to refresh your memories and for those who didn't work on it, I think it would be as good a way as any to read the memorandum that we gave the President last summer outlining what we thought we ought to get in the way of profits in view of this situation. Of course, nobody - at that time we were talking about a four billion dollar national defense and today it is forty billion dollars, but the memorandum that was written last summer still looks pretty good, so--

Magill:

I would like to hear it. I haven't seen it from that day to this.

H.M.Jr:

We haven't discussed it. People say, "Why hasn't the President said anything?" Well, it is just - he doesn't like taxes any more than I do, to talk about them.

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I don't know any better way unless somebody has a better suggestion to start than to read this memorandum which we worked on - who has it?

Foley: Here it is. It is only a copy, Mr. Secretary.

H.M.Jr: Then I will let you read it. Your eyes are younger.

Blough: I had a copy I made, Mr. Secretary.

H.M.Jr: Well, will you read it?

Foley: All right.

This is prepared by Sullivan, Magill, and Paul and submitted--

H.M.Jr: If it is agreeable - do you want to hear the whole thing or do you want to interrupt him as he goes along?

Eddie?

Greenbaum: I can't tell until I have heard it.

H.M.Jr: All right.

Foley: This was submitted to the President on the eighth of July, 1940.

"Question. Shall we adopt, A, the war profits or emergency profits principle adopted in England and, in part, in Canada and which taxes profits above the pre-emergency level or, B, the excess profits principle adopted in our 1918 act which taxes profits above a stated percentage of invested capital. Eight percent in our 1918 act, or C, a combination of both principles.

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"Comment. 1. The trouble with the straight war profits principle is that it will not reach corporations with a high level of profits. It would virtually exempt many of our largest business units which had immense pre-emergency profits and, at the same time, it would burden heavily their more unfortunate competitors which have not done so well in that period. For example, J. C. Penney is believed to have made a high return on its invested capital year after year.

"2. The trouble with the straight excess profits principle is that where the invested capital is large, it will permit the escape of huge emergency profits. For example, American Car and Foundry has a large invested capital but a low rate of return. It would pay little or no tax, even though its profits increased greatly. There are a good many companies which have not made much of a return on the investments for years but whose profits will be greatly increased because of the defense program.

"3. A combination of the two principles seems essential to a fair workable tax, one which will tap a maximum of emergency profits and excess profits on a broad basis with a minimum of disturbance to business incentive and emergency preparation.

"Proposals. It is therefore proposed, percentage figures merely illustrative, the tax shall apply to all profits in excess of the rate of return on invested capital which the corporation has actually realized in the pre-emergency period subject to two qualifications.

"1. The company shall be allowed an exemption

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of not less than four percent of invested capital, and

"2. In any case it shall be subject to the tax on what it makes above 10 percent of invested capital.

"For example, A, if the company made an average of five percent on invested capital in 1935 through 1939, its profits above five percent in 1940 will be subject to the tax. B, if it made an average of only two percent in the period 1935 to 1939, any profits in 1940 above four percent will be subject to the tax."

Gaston: Above four percent?

Foley: "Above four percent will be subject to the tax. C, if it made an average of fifteen percent in the period from 1935 to 1939, the tax shall apply to any profits in 1940 in excess of ten percent. This scheme gives greater flexibility than the rigid 1918 act scheme of eight percent recently suggested by Senator LaFollette and is closely allied in principle to the seven to nine percent scheme of the 1917 act. It will obviate much criticism because invested capital is not the dominant factor but merely the limitation factor on the use of pre-emergency profits as a standard. By permitting a reasonable capitalization of pre-emergency earnings, it may, to a certain - may, to a certain extent aid pre-emergency high profit corporations but, by the same token, it will save from undue hardship concerns which use invested capital but which also depend largely upon individual enterprise and skill of management. It will also cause less economic dislocation because it more gradually transforms

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our tax system. Excess profits taxation of individuals should be avoided because they are already subject to much higher surtaxes than the taxes applied to corporations. Moreover, individuals, unlike corporations, cannot accumulate surpluses free from individual taxation. We are giving further study to the matter of differentiation between small corporations and large corporations. If a general excess profits tax is enacted with a steeply graduated rate which you propose, the provisions of the Vinson-Trammell Act with respect to excess profits should be repealed."

The Secretary read that at a meeting at the White House which - at which were present Secretary Morgenthau, Sullivan, Foley, Magill, and Paul, and the President asked some questions, and Randolph and Roswell explained the operation of the four to ten percent proposal, and, after some discussion, the President said, "I understand it, and I think you have hold of something pretty good there." Then he said he was satisfied in principle with the scheme that had been worked out. Then, of course, that wasn't adopted. This other thing was adopted. We have had some experience with it. We are examining the returns now, and we have got to make some kind of a recommendation to the Committee.

Greenbaum: What was the date of that White House conference?

Foley: July 8, 1940.

H.M.Jr: Now, if it is all right with you, and if Roy is ready - I don't know if he is ready - are you ready either on your principles, which I don't think you could improve much on - have you got that?

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Blough: Well, I have--

H.M.Jr: What have you got?

Blough: Seven pages of material. That is all I have been able to get. But I do have that much, and it goes through the statement of principles and through the - practically through the defects. It does not get into the remedy side of it at all.

H.M.Jr: Well, you said you wouldn't be able to, but let's hear that. You read it, will you?

Blough: There are not enough copies to go around, but there are a few to share.

H.M.Jr: You see, we are trying to divide this up into three chapters.

All right. Go ahead, Roy.

Blough: This was dictated - it has just been dictated once. I don't want to alibi, but it is not a finished job. I didn't have in mind the idea of a history in here at this time, either.

"In response to the kind invitation of your Chairman, it is my desire this morning to discuss with you the special taxation of certain kinds of profits, commonly referred to as excess profits. I shall endeavor to outline the principles which I believe should govern the taxation of excess profits, to indicate respects in which the present law fails to accord with those principles and to suggest various possible remedies which the Congress may wish to consider.

"Chapter I - Principles

"Any departure from the general taxation of

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corporate profits reflects a belief that some kinds of profits may be appropriately subject to heavier taxation than other kinds of profits, either because of considerations of equity, or because the effects on the economy of imposing taxes on such profits would be less harmful than raising the same amount of revenue from other sources.

"1. Defense profits

"The first type of profits which should, in a period of this kind, be subjected to special taxation comprises the profits which may be reasonably attributed to the defense program. Such profits are being made out of the sacrifices of the people as a whole and should be returned to the people in taxes, insofar as may be possible without destroying necessary incentives to produce defense goods.

"In a majority of cases it is not possible to distinguish precisely the additional profits due to the defense program, since the effects of defense spending are diffused throughout the whole economic system. It is necessary, accordingly, to approximate profits due to defense by assuming that in general, increases in profits during defense period were due to defense. Some relief can and should be granted where it is clear that such is not the case. Inability to distinguish just what are defense profits should not discourage us from subjecting them to special taxation even at the risk of hitting some non-defense profits.

"2. Profits in excess of a return on invested capital

"The other kind of profits that can properly be subjected to special taxation comprises profits in excess of a reasonable return on

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invested capital, whether or not this return was earned prior to the period of the defense program. The defense of such profits" - I am sorry. "The existence of such profits, while often merited, are in very numerous cases due to monopoly, imperfect competition, or luck and chance, and not to any outstanding service to the public. These excessive profits represent in a large part money taken from consumers in excess of the amount necessary to pay for the goods or services. When the imperfections of our economic machine permit this to happen, it is equitable and desirable that the excess profits be subjected to special taxation. Furthermore, at a time when heavy taxes must be imposed, they should be levied where they will have the least harmful effects on economic activity. To take an especially large share of the profits in excess of a reasonable return on invested capital will not cause any companies to go into bankruptcy or to reduce the scope of their activities.

"I am aware that excessive profits and for that matter the expected defense profits have been so anticipated by the financial community that security prices have become adjusted to them and that the imposition of these special taxes may hit some owners of corporate securities harder than others. While we cannot entirely disregard such vested interests, we must remember that no legislation is passed and no progressive step is taken which does not disturb the established interests of innocent people.

"I am also aware that the application of the principle of taxing profits in excess of a reasonable return on capital involves difficulties of both theory and technique. I feel sure that we should not allow these difficulties to stand in the way of our seeking

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to attain the main objective, mainly the special taxation of profits which should be subjected to such taxation."

H.M.Jr: May I interrupt you there? I think you have done an amazing job. You only started this at ten thirty?

Blough: Nine o'clock, Mr. Secretary.

H.M.Jr: Nine o'clock, all right. I think it is amazing.

Blough: After several years of work.

H.M.Jr: All right. (Laughter) Well, the reason I think it is amazing - well, after all, we have been sweating on this thing now for I don't know how long and it looks as though we are going to see daylight.

Blough: "Chapter II - Defects of the present law

"In the light of the principles just stated, I wish to examine the excess profits tax law passed last summer, to see in what respects, if any, it fails to correspond to those principles.

"1. Failure to reach large parts of defense profits" - and that was written last night - "The Excess Profits Tax Act of 1940 was a clear expression of Congressional intent that profits growing out of the defense effort should be subject to excess profits tax. The law, however, has not achieved that objective. Many corporations that are the principal beneficiaries of the defense effort and that hold large government contracts are paying little or no excess profits tax. Some of these corporations are not only making more profits than they do in normal times

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but are finding it necessary to expand in order to fill defense contracts.

"In the absence of excess profits tax returns an examination has been made of published financial data for certain corporations. One company which, through March 31, 1941, had received \$73,000,000 of defense contracts" - this is American Car and Foundry, incidentally - "and whose profits in 1940 were more than 3,000 percent larger than 1939 is subject to no excess profits tax whatever on 1940 earnings."

H.M. Jr: Roy, you are a man after my own heart. We are getting down to brass tacks now.

Blough: "The financial data of one of the large steel companies which has received nearly \$400,000,000 of defense contracts" - this is U. S. Steel - "indicates that its earnings in 1940 will be nearly 200 percent larger than in 1939 and that it will not be subject to excess profits tax. It is reported in one of the financial periodicals that only 5 out of 12 large integrated steel companies will be subject to excess profits tax on the income of 1940, although it will be borne in mind that the steel companies have in general received huge amounts of defense orders.

"These companies escape excess profits tax in whole or in part because of the allowance of a minimum credit of 8 percent of invested capital. This provision was inserted by the Congress not to protect these corporations, but to aid corporations that were small and growing, newly formed" - I think we had better strike - "or in a depressed condition--"

We meant one kind of depressed condition, but

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it may be misunderstood.

".... small, growing, or newly formed and that needed the safeguard of a minimum untaxed return on invested capital. The law did not distinguish among kinds of corporations and as a result did not either tax the defense profits or adequately protect the corporations needing assistance.

"We have been besieged by legitimate requests for relief. An amending bill was passed in March of this year to give such relief and there are still cases not provided for."

That needs some trimming up.

"2. Excess profits other than defense profits not taxed

"Another serious shortcoming of the 1940 excess profits tax law is that profits in excess of a reasonable return on invested capital are not subjected to the tax unless such profits also represent an increase over the profits of the base period. For example, one company which earned during the base period an average of approximately 37 percent on its present invested capital will be free from the excess profits tax on income in any year equal to approximately this 37 percent (the average earnings credit being only 95 percent of - " that will have to be dressed up - "base period earnings) and will be taxable only on such increases in income as it may enjoy. The failure of the law to reach a large portion of excess profits was due to the provision of a credit for every corporation equal to 95 percent of its base period earnings, regardless of the size of those earnings in relation to its invested capital."

That is as far as I have gone.

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H.M.Jr: I think that is swell.

Greenbaum: Very good.

H.M.Jr: Don't you, John?

Sullivan: Oh, yes, he has done remarkably well.

H.M.Jr: I think he has done an amazing job.

Sullivan: When I heard this example of the American Car and Foundry last night, the question immediately came to my mind, would they have paid the tax under the Treasury proposal?

Blough: I think not, sir. Even under the proposal--

Magill: You mean under this thing last summer.

Sullivan: That is right.

Gaston: You mean they didn't reach four percent?

Blough: I don't believe so. I have checked that, but they are still very low. Maybe I have the figures right here.

H.M.Jr: Well, do you mind just holding it because I just want to get the whole outline before these people and ask their help.

Have you, in your mind, any recommendations?

Blough: Well, I have the rest, part 3 of that outline which I handed you this morning, in which the purpose was to indicate, if not a recommendation at least some of the remedies which might be given, and I can just read that section if you wish.

H.M.Jr: Please.

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Blough: "Chapter III - Remedies"

This is just a brief outline.

"1. The first defect" - that is, namely, the fact that many of these low earnings companies are not being taxed because of the eight percent minimum. "The first defect may be remedied at least in part by reducing the minimum exemption below eight percent, either through; A, reducing the percent of credit; or, B, doing the same thing in effect by disallowing the normal tax as a deduction in computing the excess profits, or both, for that matter.

"2. The second defect" - that is the high earnings companies' base period, which have no tax because - or very little tax, no tax on those earnings - "The second defect can be remedied by placing an upper limit on profits which can be earned free from tax."

This job was done very rapidly. I don't know if the organization will stand.

Then, "Then the original Treasury proposal contained both of these remedies, at least in part, in that it had a lower minimum of four percent, six on the first five hundred thousand of capital, and it had an upper limit of ten percent."

And then I think that in any suggestion of remedies we should hasten to say that the provision of a maximum return on invested capital or, for that matter, any use of invested capital, but particularly on maximum return, involves you in great difficulties in defining and measuring invested capital equitably, so that if they come back and say, "Well, now, what are your suggestions?" we will at least have warned

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them that we realize an application of these principles is not as easy as falling off a log. And that was the line along which further writing was to proceed.

H.M.Jr: Let me ask you this, Roy. If we took this recommendation which we made to the President July 8 and then put in there a floor, that no matter how this hits any company, they have got to pay a minimum of so much, would that take care of any possible loopholes?

Blough: The minimum tax, in my opinion, is pretty much a failure as a - a confession of failure of an excess profits tax because the minimum would apply to everybody, whether he made a lot of return, whether he made a little return, whether he had defense profits, whether he had excess profits or not, and it is just a flat rate on everybody in effect, and I am just wondering whether it doesn't gloss over the fact that you have not succeeded in measuring.

Now, if companies in general aren't paying enough, then you can put in a minimum, but that minimum will apply to a great many companies besides the companies that you are trying to get, and that is the only thing I feel about it.

Gaston: How would it do to suggest a rather low rate of excess profits tax on all the excess over previous earnings, quite a low rate, and then come in with your stiff rates when they reach a certain ceiling, such as four percent in the proposal of last year or some higher figure? That is, a progressive rate of taxes which would be shaded quite low in the area between what they were making and what may be judged to be a reasonable rate of return.

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- Blough: We suggested that last summer when we were in the swamp down there trying to get some where. We suggested that we take the higher credit of the two and on the earnings over the higher credit of the two apply a full rate of tax, and then on the difference between the higher credit and the lower credit, apply a lower or partial rate. We have also given some consideration to that this year, but it meets the same criticism that all these attempts to get at invested earnings over percentage of capital meets.
- H.M.Jr: Ros, you see just how far we are, you see. Have you any suggestion - I mean, with this talent here - you people were kind enough to drop what you have been doing to help me out - how we can make progress in the easiest and most successful manner from this point on, do you see? Do you see what we are trying to - how would you proceed? Have you got any suggestions?
- Magill: I haven't given it any thought. May I just give my offhand reactions to the situation as it has developed here? As I said, I hadn't seen that memorandum of last summer from that time to this. I didn't remember it at all in detail.
- H.M.Jr: Don't you think it is a pretty good memorandum?
- Magill: It seems to me, yes, as far as I look at it today, that that proposal is very much better than the present law, and I think with this elaboration which Roy has given, so far as I can see, you get a workable scheme of things. As I understand and as I get the picture here, the only corporation about which - the only type of corporations about which you would be much concerned would be your American Car and Foundry type, that is, a company which had

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a big invested capital, comparatively low earnings, even with large defense profits taken into account. I mean, a comparatively low rate of return. I would--

H.M.Jr: May I interrupt you?

Magill: Yes, please do.

H.M.Jr: Let's get - this is important. That has been our trouble here. We haven't understood each other inside the Treasury. We are not only worried about those, but in the light of what is happening and in the light of the sacrifices that we are asking a million and a quarter men to make, we don't - the man who is getting a thirty-six hundred dollar salary and has got to go in and work for three hundred and sixty dollars a year, we just ask him to make that sacrifice. That is his contribution. And therefore, we feel that aside from these American Car and Foundry type, a company who, over a period of years on account of whatever the peculiar circumstances are, have been enjoying a very high rate of return on the original invested capital, that they should be called upon to make additional contributions, even though they might not have a dollar's worth of defense contracts.

Magill: I made two notes on this as we went along.

H.M.Jr: I mean, don't jump on me, John. You had a chance.

But I mean, the facts remain that if the man - if everybody who puts original money in Coca-Cola were still the same crowd, they are getting forty-eight percent return on their original money. It is also true that if I bought a share of Coca-Cola today, I would only get five or six dollars, see.

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Because I mean that is - something like that, you see. But the fact remains that there are a great many companies who are earning thirty, forty, up to fifty percent. They say due to peculiar circumstances, a patent or a monopoly, and we simply feel here that that group today should be called upon to make an additional contribution toward the expense of arming ourselves, even though they don't have a dollar of defense contracts, and that is the place I think possibly where John and I haven't seen eye to eye.

Sullivan: That is correct, sir.

H.M.Jr: Is that correct?

Sullivan: Yes, sir.

H.M.Jr: That is where you and I haven't seen eye to eye.

Sullivan: That is a fair statement.

H.M.Jr: So you get the whole picture.

Magill: Of course I haven't had the benefit of the discussions which you must have had here, and I honestly don't know too much about the operation of this excess profits tax. I see it cropping up every once in a while, but I don't really know very much about it in actual fact. Dealing off the cuff, my inclination would be to agree with you.

Take your J. C. Penney Company, for instance. There are undoubtedly thousands of people who own Penney stock who bought it on the basis of a return on the price at which they bought it and that didn't take into account the possible excess profits tax grounded on a higher rate of return which Penney is making. However,

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I think you answer that in two ways, one technical and one another one. Technically, our tax system has been based, I think, possibly wrongly, but still that is the way it is based, on treating the corporation as distinct from the individual stockholders who own the corporation. We tax the earnings of corporations without regard to the stockholders. We certainly have been doing this since 1936 without relation to who owns them at all. Consequently, I think you can support technically a continuation of that mode of taxation by cracking the Penney Company because it is making big profits, irrespective of the fact that it may be owned by a lot of people to whom that mode of taxation isn't particularly fair.

Then, secondly, I can illustrate what I have in mind by an oblique attack. I don't honestly believe that you people in Washington here realize as well as we do up in the sticks in New York that times have changed. These aren't peace times. We are in an emergency situation here. I think people are prepared to sacrifice very much indeed, and I don't think you have capitalized on that as much as you can.

I was talking, for instance--

H.M.Jr: May I just interrupt you a minute?

Magill: Sure.

H.M.Jr: For the benefit of Roy, if we agree to this thing, I don't think that we have been sufficiently waving the American flag and pointing out that we expect the other companies to make it on a basis of national unity, even though it may seem unfair at the first blush.

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I don't think that that thing has been stressed enough, you see.

- Gaston: That is the defect I noticed here. I think it ought to be preceded by an introduction which will set the stage of the situation we are in now and the demand for great sacrifices.
- H.M.Jr: That is a thing Herbert could do very well, but I wouldn't expect Roy to do it. I don't think we are sufficiently demagogic in our presentation.
- Magill: You ought to get a good newspaper man or something like that.
- H.M.Jr: What is the matter with Herb?
- Magill: I don't know, what is the matter with Herb?
(Laughter)
- H.M.Jr: I think that thing has to be driven home.
- Blough: I agree, Mr. Secretary, but I just don't happen to be able to do that, and I would rather turn it over to somebody that can.
- H.M.Jr: We have got enough people around this shop. I just think that has got to be blown up. Excuse me. I am sorry.
- Magill: To go on, I was going to say this. I was talking to Carl Shoup the other day. Why it is in these times that the Federal Government doesn't propose a taxation of the interest on all state, municipal, federal, any damn kind of bonds--
- Foley: I haven't said a word.
- Magill: Tax exempt or otherwise. Now, in peace times

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I wouldn't advocate that because I have always thought that it was a sort of breach of faith, these securities having been issued the way they were. Today it doesn't seem to me that it is. I don't know why you can't say that a fellow that bought this bond, even thinking that it was going to be tax exempt. "Now look, you are enjoying three, four, five, or whatever it is, percent return on these securities, and who are you to say that you shouldn't be taxed at all by the Federal Government. I don't care how you got this bond, dammit, you have got this return on this investment, and if other people are going to pay taxes on their incomes and your thirty-six hundred dollar soldier getting three hundred sixty dollars and so forth" - I didn't know he got that much--

Foley: There is some question whether it is twenty-one or thirty.

Magill: I thought it was twenty-one.

"Well, why shouldn't you fellows pay," and really I, personally, have been amazed at your reticence and restraint in that particular regard. Well, if that general philosophy is correct, then I don't for a minute see why you can't say to the Penney Company, "You fellows, after all, are making twenty-six percent. Now, we know that there are a lot of widows and orphans and so forth in the world, but still the fact is this tax is on you and you are making twenty-six percent, and in times like these we think that whatever you are making above ten could be taxed at such and such a rate." So I think you have got a good case for the sort of proposal which we have in mind here.

The only alternative that occurs to me is

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quite a different one. I advance it with a good deal of reticence, but I advance it because I haven't thought about it and I think the rest of you might have it in mind, at least, if, for example, John is worried about the inequities of this proposal, which are quite clear, would you feel any better if you gave corporations some form of credit of dividends distributed?

Now, in an excess profits tax, they could avoid the tax to some degree if they distributed the excess profits to that extent. Now, that has been proposed before. That is not original with me. I think it has a certain amount of merit in it, but again, purely off-hand without thinking it over very much, my disposition, if I were advising you in this situation, would be to say to you to take that program of last July plus what Roy has got here and recommend that to the boys now without any such gadgets as this credit. You have got to do a job if you are going to increase the excess profits tax rate. You have got to do a job on this present tax law. You can't justify increasing rates with the present law on any decent basis, it seems to me. For one thing, the damnlaw is crammed full of exceptions for every kind of thing that everybody can think of. Those were all stuck in last summer, as we know. Some of them are quite justifiable and all of them have some shadow of justification, but still you are just trying to dip water with a sieve when you use that last summer's law.

H.M.Jr:

Somebody said sarcastically, "If a corporation didn't get the exemptions it needed, it was just because it didn't have the price to hire a lawyer."

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Gaston: I think that figure of speech is awfully good, Ros. We might use it in the talk.

Sullivan: I don't think there were any more lawyers to go around. They were all up there.

Magill: There was one technical matter here that Roy mentioned at the end that bothers me a good deal, and I think I would go a little beyond what he suggested. Under this proposed scheme, the computation of invested capital becomes about twice as important as it is under the present law. Because under the present law plenty of corporations don't have to compute invested capital at all in any technical fashion. They just compute it in a rough way to see how they are going to come out under it, and they use average earnings instead. Under this one they would certainly have to compute invested capital.

Now, I don't think that a layman understands the tremendous difficulty of that computation in the case of most any corporation. It is extremely hard. I was looking at one, for instance, the other day which I think is typical. The corporation had its origin about 1906, and then it began collecting other corporations and, in its particular case as far as I could make out, they were all non-taxable reorganizations, so that in each case you go back to the cost of the predecessor company. Well, the books of the predecessor companies are not in existence any more and to ascertain the cost is just literally impossible. You don't know what it is. There was finally in this case a big reorganization in 1927. That again was a non-taxable reorganization, so again you have to go clear back. So that here is a company which is - has very large invested capital, but they don't know themselves whether it is one figure or another

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figure that is more than twice as much, and there is literally no way to find out.

Well, to come to the point then, if you are going to do something like this, it seems to me you must set up machinery in the Department whereby you get a quick and, if possible, advanced determination of what invested capital is in these tough situations. Otherwise, you are going to be dragging around for years on this thing because the material just isn't there.

I don't think the present law gives the Treasury enough leeway with respect to the determination of invested capital in these cases of the kind I cite. I would suggest there certainly some kind of machinery in the law whereby you get busy and determine this invested capital and the Commissioner has some kind of discretion to fill in the blanks where there are blanks. It is a bad business, but I can't help it.

H.M.Jr: Mr. Knollenberg?

Knollenberg: Well, I feel very much as Mr. Magill does. In fact I see eye to eye to him.

As an original proposition, I was very strongly in favor of Herman Oliphant's general plan of having only a very slight excess tax, perhaps on corporations and forcing them to distribute their profits and then collecting it under the income tax law, and I have always been wedded to that theory, but we are so far away from it now that obviously we can't cross - get on to the other side of the stream at this stage, and so having once pursued the line of treating a corporation as an entity, personifying it as we have done in this emergency, it seems to me that we have to continue along

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that line and to adopt this proposition that you suggest, that rich corporations have to be treated - I mean rich in the sense of making a large return on their invested capital, have to be treated as if they were individuals and forget what the position of the specific stockholder is. I don't think that is equitable, but I think our whole corporate tax structure is inequitable and this further extension of it doesn't particularly pain me. It certainly is the way to raise the money.

H.M.Jr: There has been a suggestion made that we have a flat tax on corporations, say, of forty percent and then a very stiff undistributed profits tax to go with it.

Knollenberg: Well, that is the kind I would like. Perhaps not as much as forty percent for the excise tax, but an absolutely drastic undistributed profits tax that would force corporations to distribute. That is what Oliphant believed in and so do I.

It has always seemed to me the sound system.

Magill: That is what I was trying to tell you on Saturday. I think Nollie has expressed it very well.

The fairest way that I know of for taxing corporate earnings is to tax them at the rates applicable to the individuals. Now, I rather, as I tried to tell you in a memorandum, I rather think that the Supreme Court at the present time would uphold that method of taxation. That is, corporate earnings, whether distributed or not, are subject to tax pro rata to the individuals that own the stock. But that is a tremendous change from anything that we have done, and so I don't think it ought to be proposed at this particular moment.

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I think you have got to build it up a little first.

Foley: I think he is right.

Magill: The alternative to that would be Nollie's stiff undistributed profits tax which doesn't need to be called that. Don't be frightened by the name, if you are. You can propose a corporate tax and say it is fifty percent and say, "O.K., boys, this is what you pay, but if you distribute you get such and such a credit." I don't know whether fifty would do it. But somewhere in there.

The corporations would say, "Well, we had damn well better distribute and let the stockholders pay the tax."

H.M.Jr: Is there any reason, because Congress has given us permission and invited us to come up and give three or four alternatives, why that couldn't be suggested as a possible alternative?

Magill: I think it would be well, if I am correct in my philosophy, that in all probability at some time you will want to come to the type of tax that Knollenberg and I are thinking of. It might be well to give them some kind of an inkling of what is running through your mind at the present time.

H.M.Jr: There will never be a better time, because I was amazed when they agreed that we should come up and, one, criticize this bill to our hearts content and, two, make as many suggestions as we felt was necessary as possible alternatives to raise the money necessary from the corporations.

Foley: The only trouble, Mr. Secretary, with that is

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that you are liable to upset unduly the situation that exists now.

H.M.Jr: What is that?

Foley: Well, you have got a bill. Everybody admits something has got to be done about that bill. But if you revolutionize the thing and you go back to your undistributed profits tax theory, you may - you may unduly upset the whole business level.

Greenbaum: That is what I was going to inquire about.

Foley: I would rather, if we are going to do it, and I think we have got to do it some day, do what Ros says, give them some inkling of what was running through our mind and tell them that that is what we are working on, but give them a concrete proposition now to take care of the existing law so that we get the revenue and at the same time we remove some of the inequities that exist where a few corporations aren't paying anything and a large number of corporations aren't sharing in the defense program and another group of corporations is carrying the whole load in so far as your excess profits go. I think if you do a shotgun job now, you may get everything all upset. That is the only thing that bothers me.

Gaston: Ed, I think this can be stated in such a way - I think we owe it to the Committee to show that - to let them know that the Treasury has never given up the idea that this taxation of corporate profits to the individual is the correct system, and I think that we can handle this suggestion of the forty-fifty percent corporate tax with an allowance for distribution. We could handle it in such a way as to indicate that we are thinking of

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that as a long-range, equitable plan of taxation, as indicating a long-range, equitable plan of taxation, but we are not urging it now.

Foley: That is all right.

Gaston: But suggest it to them.

Knollenberg: And a simple plan, not only equitable.

Gaston: And if they like it and want to go on it, what harm?

H.M.Jr: Yes.

Magill: I hope if you do that, for goodness sake, you will explain to them that to do what they did before, to compromise the whole scheme as they did in '36, simply ruins it. They had better leave it absolutely alone instead of going into this compromising business which they did before.

Greenbaum: It is not clear to me just what we are discussing. As I understand it, Mr. Blough's statement indicates the objective is to make recommendations in regard to the present excess profits tax, to reach the profits on defense work which are escaping from it now, and the other inequities which resulted. We are going far afield from that. In spite of the invitation extended to you, is it open or advisable to go on other things?

Ros suggests the question of income taxes on individual holders of state and municipal bonds. Now we are talking about the undistributed profits tax. What are we limited to?

H.M.Jr: I don't want to bring in that taxing of - I am

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not ready myself yet for that, I mean the taxing of outstanding state and municipal bonds. We have got a lot of things started on that to do it the other way around. This suit with the Port of New York Authority and all the rest of the stuff.

Magill: I mentioned that simply by way of illustration, Eddie. That wasn't point one of my program.

Greenbaum: That is what I understood. If we want to limit ourselves, why isn't the thing to do in view of the fact that you want to get something to the White House tomorrow and you have to be ready on Monday, to go back to the July 1940 suggestion? We will see what - if those had been adopted, what would have been the consequences of these cases pointed out?

As I understood, in answer to a question of John's, the American Car and Foundry situation wouldn't have been buttoned up with that. Why shouldn't we follow from what Roy Blough has, going back to the July '40 to see that, and then also, incidentally and parenthetically, mention the undistributed profits? In another form it would be really a credit for distribution.

H.M.Jr: Well, Eddie--

Greenbaum: I think you would get much--

H.M.Jr: I agree with you. On the question of suggestions which come under what I call chapter three, the way I feel now is that the most consistent thing to do is - and I even raise the point at this time of possibly publishing our memorandum to the President of last July to show just where we were, and this isn't something that is being jammed down our throats by certain people.

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But then taking this thing in the light of the time that has gone by and simply strengthening it where we see that suggestion of last July was weak, that is all. If there are certain places that are weak, just strengthen them.

Could that be done, Roy?

Blough: Yes indeed, it could.

H.M. Jr: What would you suggest in view of what we know now? What loopholes would be left open from the July suggestion? What would we have to do to strengthen that?

Blough: I think the one that Herbert mentioned, namely, that even the four percent leaves out, as Mr. Sullivan pointed out, the American Car and Foundry situation. Now, it occurs to me that a somewhat lower rate of tax could quite properly be imposed on profits in the current period in excess of profits in the previous period even below that minimum so long as the tax was maybe ten percent or something like that, wasn't too awfully heavy, so that it would hit a lot of people very hard that you wouldn't want to be hit so hard.

H.M. Jr: Well, if I could sum up - if this could be done, always provided that you people think I am right. If you don't, I know that you will tell me. If we started out pointing out that we are considering a revenue bill to raise a certain amount of money, that this was our position last July when we were talking about four billion dollars worth of national defense, and we are now talking about ten times as much, that our first job is to raise the revenue, but the second and collateral thing is that we want to be able to skim off a certain amount of money to keep it from being used to buy merchandise and aggravating the shortage which

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already is beginning to exist of goods. We can do so much by getting the people's savings in defense bonds and so much in the tax law, but on the Treasury is the responsibility to keep inflation from getting worse. As I see it, so much through the people's savings on the defense bonds and so much through taxes.

But the first is the revenue. I think if that - as I say, I am just thinking out loud, if that could be pointed out. Then hit awfully hard the inequalities in the present law and make it perfectly clear that we not only want to get the excess profits which are due to the money that the Government is spending, but in view of these unusual times and unusual circumstances and the sacrifices we are calling on the draftees to make, we think it is only fair that the companies who have enjoyed the special privilege of large profits over a period of years should also be called on to make their contributions, and then third, and last, make as good a suggestion as we can for the kind of bill that we think would accomplish it.

Magill: That is right.

H.M.Jr: But I - you see, we can do so much from getting the people's savings through defense bonds. Then we can do so much by skimming off the money through the taxes. I will just be repeating myself.

Now, that is the way I look at the problem and what I would like to do is, if I could get it to the President, say to him, "Now, are you and I seeing eye to eye, because we don't want to go on the Hill unless we can say the President has approved this," and he may have different ideas. If he has, certainly he has never been hesitant to say so.

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- Greenbaum: You suggested before, Mr. Secretary, the possibility of publicly referring to that July 1940 statement. Why wasn't that given publicity then? The President approved that.
- H.M.Jr: Didn't think of it.
- Sullivan: Before two weeks had elapsed he told Pat Harrison and Bob Doughton to just get him anything that would be called excess profits, and he didn't care what was in it, to get the bill out and go home.
- Greenbaum: I had in mind something like that. It might be inadvisable to publish it as something of last year, 1940.
- H.M.Jr: As I say, I am making suggestions, and I want you fellows to knock it down.
- Sullivan: I hadn't thought of that, but I don't think we should give that out as of last year.
- Gaston: But, at any rate, it is the President's property.
- H.M.Jr: True.
- Gaston: Until he consents to publicizing it.
- Sullivan: I would like to ask Ros a question.
- H.M.Jr: Go ahead. I just wanted - do you mind just one second? Couldn't we release Roy now so he can go ahead with these ideas and do some more dictating? Should Roy hear what you (Sullivan) are going to say?
- Sullivan: No.
- H.M.Jr: Wouldn't you be gaining time?

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Blough: Every minute.

Sullivan: You might order your breakfast then too, Roy.

Blough: I will try.

H.M.Jr: Hasn't he had any breakfast?

Sullivan: No.

H.M.Jr: Didn't you have any breakfast?

Blough: I had enough.

H.M.Jr: Have some coffee. Nothing at all?

Sullivan: No.

Blough: I had a little something. Don't worry.

H.M.Jr: That is easy enough. We can take care of that.

Sullivan: The question I wanted to ask, Ros, is whether or not you think the effect of placing a ceiling on profits such as we propose to do in the original Treasury plan would have any substantial effect on the market or create any kind of disturbance that we ought to worry about. That is what you (Greenbaum) had in mind, isn't it?

Greenbaum: Yes.

Magill: Well, that is really two questions. I should think it ought to have an effect on the market.

Sullivan: Oh, I don't mean that kind, but I mean is there anything about it we should worry about.

Magill: Well, I think yes. The trouble with any excess profits tax, you have to decide on all of

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these things that have been mentioned, it is necessarily more or less of a meat-axe proposal. It suggests corporations of all sorts of circumstances and positions and what not, a more or less uniform rule.

Now, the Treasury proposal, I think, is better than the present law in that regard because you do have a little sliding scale in there. But I think it unquestionably would be true that the corporation would reflect - for instance, if it refunded a certain bond issue and saved some money on the interest, that the effect might be to create an excess profits at a high rate of tax and hence you had better not refund the bonds.

The effect of the thing, I think, will certainly be to make business enterprise much more conservative because the penalty for making money is going to be pretty severe.

H.M.Jr: Did I interrupt you?

Magill: No, not at all.

H.M.Jr: I think the place that Roy is going to have the most difficulty is - if any one of you could be drafting on that - is on the suggestions for the changes. He is going to have his greatest difficulty there.

Magill: You need to suggest, for your purposes, much more than this last year's memorandum. I don't think I would because the thing has got to be redrafted. There is a terrible lot of detail work to do.

H.M.Jr: They don't want us to do that. They said just make the suggestions.

Magill: You are not charged with that? That is not

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your responsibility?

H.M.Jr: Well, I wondered if we gave, say, Roy, until three o'clock, to have something again, and then we could meet again then. I would like him to - to get what you fellows have got and what Gaston has got so he would have the benefit of that. Maybe we could just sort of rest until three.

Magill: Gaston ought to be able to help him a great deal by dictating a couple of pages of introduction to this.

Foley: You have got some of that anyway.

Gaston: I had something in here, but I think maybe I can do better than that.

(Mr. Kades handed copy of Mr. Gaston's memorandum to the Secretary.)

H.M.Jr: This is Mr. Gaston's?

Kades: This is Mr. Gaston's and ours combined.

Greenbaum: Is it part of Roy's job now to analyse the July 1940 statement as a proposed remedy and see how that would work in?

H.M.Jr: Yes.

Could you people be back, say, at three?

Greenbaum: Yes.

H.M.Jr: Does it make it a little better for you people?

Greenbaum: Yes, it would, unless there is something you wanted of us.

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- H.M.Jr: I think if you could be back at three unless you have got something you want to suggest. If either of you think we are off on the wrong foot--
- Greenbaum: No, that makes real sense to me.
- H.M.Jr: Think we are off on the wrong foot?
- Knollenberg: By no means. It is excellent.
- H.M.Jr: I think if we will just adjourn now.
Get this thing of Gaston's to Roy now, will you, John?
- Sullivan: Yes.
- H.M.Jr: Are you going to do something on the introductory paragraphs?
- Gaston: Yes, there is something of that in here, but I will go at that - it is woven in with some stuff about the present excess profits tax law, and I think we want to eliminate all reference to suggested changes or what is wrong with the law in this introductory paragraph, but just try to state the crisis we are in and the need for sacrifices.
- H.M.Jr: Are you happy as far as we have gone?
- Foley: Yes, sir.
- H.M.Jr: How about you, John?
- Sullivan: I am all right. I can go ahead on the plan last year on the basis that we have been discussing today, that it is a meat-axe proposal and that we are now in a national emergency and we can't be concerned with the niceties of the situation. We will have to ask for a

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lot more money than three and a half billion dollars.

Foley: Well, I think it will produce more money, but I think we will need it, don't we?

H.M. Jr: What?

Foley: It will produce it, but we need it, don't we?

Gaston: To fill the three and a half billion dollar program, he is asking for nine hundred thirty-four millions from the corporate taxes. I think we are going to, if they adopt our suggestion here - they are going to produce a bill that will yield at least a billion and a half, and there is no loss there. We will have over four billion instead of three and a half billion.

Greenbaum: What does the present proposition contemplate producing? What is the estimate on that?

Foley: Nine hundred thirty-four million.

Magill: From excess profits, how much?

Foley: Between five and six, isn't it, John?

Sullivan: We will collect in fiscal '42, six hundred seventy-five million, but the calendar '41 liabilities under the present law are a billion twenty-five million. That is without any changes in the law.

Magill: That is an amazing increase, isn't it?

Sullivan: It is very much higher.

Foley: And this will bring it much more, this plan.

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- Gaston: This is purely excess profits tax.
- Sullivan: That is right.
- Magill: I had no idea it was as big as that. My gosh, you used to talk about two hundred million when I was a boy.
- Greenbaum: Won't you be up against things there then? You are getting much more than was contemplated, and now you are criticizing the fact that it isn't revenue producing enough.
- H.M.Jr: No, no.
- Foley: We are spending forty billion now. Last summer we were spending four.
- H.M.Jr: Eddie, let me get this to you if I may. This is the thing that I think you just can't defend when the man on the street understands it, and that is how some of these very big corporations with these - get away with what they are going to get under the present law. I mean, it will seep down, and the people are going to say, "Well, why does such and such a corporation make such and such abnormal profits when we" - I keep talking about the soldier, and hell, he is the only fellow today that is doing anything to in any way sacrifice. When I have got to give up my nice three or four thousand dollar job, my whole future, interfere with my whole life and go out and work for a dollar a day. Now, when those things come down, I just think it is going to make for great dissatisfaction and restlessness. It isn't just - I am not just thinking about how much money we are going to take in. I am thinking about - here you are calling on these fellows to do this thing, and nobody is trying to make up the difference to them now. Just because they happen to be under

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a certain age they have got to do it.

Greenbaum: I agree that should be stressed, but it seems to me there is something that has been overlooked in this statement. It is true that the stress is on the inequalities of the present law, but the sacrifices you are proposing to call on people to make is no sacrifice compared to what the soldiers are doing. It is a sacrifice that other tax payers under that law are today making. If you are getting income like that out of it - I think you should stress more the inequalities within the provisions of the tax law as well as these other sacrifices.

H.M. Jr: I agree with you.

Greenbaum: Showing that every tax payer is today - all except those who are being preferred by this inequality, are today making sacrifices.

H.M. Jr: Yes.

Greenbaum: I think it is very important to show, particularly in the light of those figures that John gave, which were a big surprise to me and to Roswell too, that tax payers today on the excess profits tax are paying, and you can say, "Cheerfully paying," large sums in the form of sacrifices and what not, and the idea is to make those who should be paying it, do the same. That may be a minor point, but I think it is important to get it in.

H.M. Jr: I think if you two War Department fellows will come back here at three we will have something for you further.

Greenbaum: O.K.

H.M. Jr: Give me credit for the fact that I gave you off

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from twelve to three for lunch.

(Mr. Greenbaum and Mr. Knollenberg left the conference.)

H.M.Jr: I think I will break this up now.

Now, Ros, how can I make the most use of you?
Do you want to go somewhere and rest?

Magill: No, I feel swell. It is just my eye, that is all.

My purpose today is to discuss with you the Treasury's proposal for corporate taxation in the present crisis.

It is essential to bear in mind that we are in the midst of a very serious emergency. We are undertaking to exert a maximum of effort for national defense. We face the urgent need of great additional revenue to finance that effort.

The Treasury is called upon to meet expenditures greater than have ever been made in the nation's peacetime history, and probably greater than at any time in our history, in peace or war. At such a time we can not expect to rely on normal sources of revenue or be content with revenue in normal amounts. We must adopt extraordinary measures to deal with our extraordinary situation.

In searching for additional sources of revenue, we have sought to arrange our tax schedules so that corporations, like individuals, will bear their share of the tax burden in proportion to their ability to pay, regardless of their source of earnings.

It is not enough to prevent the relatively small number of corporations largely engaged on defense orders from

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profiteering. Many leading and long established corporations realized very high rates of profit even when the business index was comparatively low.

Having in mind that it is the Treasury's responsibility to make suggestions and to analyze specific proposals for changes in the tax structure and that it is the Committee's responsibility to write the tax bill, I want to outline in general how we think the corporate tax yield can and should be increased.

When I appeared before a subcommittee of this Committee last summer, I recommended the enactment of an excess-profits tax law which would apply to all profits in excess of the rate of return on invested capital which corporations actually realized in the period before the defense program, subject to two qualifications. First, such a law would have allowed a corporation an exemption of not less than 4 percent on invested capital. Second, such a law would have subjected a corporation to a tax on those profits which it made in excess of 10 percent on invested capital.

For example, if a corporation made an average of 5 percent on invested capital in the period prior to the defense program, its profits above 5 percent would be subject to excess profits

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taxation. But if it made an average of but 2 percent during the period prior to the defense program, only those profits in excess of 4 percent would be subject to the tax. And if it made an average of 15 percent in the period prior to the defense program, then the tax would apply to all profits in excess of 10 percent.

The Congress adopted a different proposal which the Treasury believed would discriminate against small and growing corporations. Because of the urgent necessity for prompt action, however, the Treasury did not press its objection.

The Treasury has never hesitated, however, to come before your Committee and ask it to remedy a defect or to eliminate an inequity whenever experience in the administration of the tax laws has revealed any defect or any inequity. Since, therefore, the method of excess profits taxation which was enacted into law last summer has proved, in our opinion, unfair and ineffective, I am not hesitating to come before you now to ask you to reconsider the Treasury's plan of last summer.

Many of the inequities of the law passed last year were remedied in the Excess Profits Tax amendments of 1941. The

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present law undertakes to tax corporation profits which result from the defense program. We renew our suggestion of a plan which would tax all excessive profits made during the defense program.

The weakness of our existing excess profits tax law is that it erects a barbed-wire fence protecting those profits of well-established corporations which are not

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primarily concerned with defense production and which, nevertheless, earn heavy profits consistently year after year.

Under the existing excess profits tax law, we are not able to touch these profits to any appreciable extent. We are not able to insure that such rich and strong corporations bear their full share of the burden.

We have a corporation tax that applies almost equally to all companies, rich or poor, great or small, and we also have an excess profits tax that in practical operation applies to new companies or to those whose earnings have jumped rapidly during the defense emergency.

The present law permits all corporations to elect to pay an excess profits tax only if current profits exceed 95% of the average profits during the base period, plus an additional allowance for those corporations which are part of a growing industry and for the first \$5000 of excess profits. But by reaching only the profits outside the barbed-wire fence, the law actually immunizes from excess profits taxation those corporations best able to bear their fair share of the tax burden. And it leaves a huge field of revenue virtually untouched.

Draft #2 5-15-41

6.

although the present emergency is such that we shall need to tap every field if the costs of the defense program are to be paid.

Needless to say, we should continue to permit these corporations which had low profits before the defense program a reasonable opportunity to recoup losses. But we can not afford to continue the existing hapsided system of defense taxation which deals so tenderly with excess profits and departs so sharply from the principle of "from each according to his ability to pay."

There is an inherent injustice in being allowed to make profits on a huge scale simply because you have always made them, and seeing other industries, newer industries, taxed on a different basis simply because the source of their profits or the course of their earnings over a long period happen to be different.

In short, the existing excess-profits tax law is discriminatory because it does not reach corporations with a high level of profit. It virtually exempts many of our largest business units which had immense profits prior to the defense program. After all, every-

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one is going to have to make real sacrifices before this defense effort of ours is over. And every person, whether individual or corporate, is going to have to dig deeply into his treasure to help the country surmount this period of crisis.

There has been much talk of the sacrifices the American people have made and are making. Let us be realistic. Nobody has yet made a real sacrifice except the boys who have been drafted and their wives and families who wait at home.

Events have moved so fast that we can no longer apply the standards which seemed good enough a year ago. The situation today is substantially different and the emergency is far more serious. We were spending \$4 billion on defense a year ago. We are spending \$40 billion on defense today.

The excess-profits tax in its present form does not produce adequate revenue in the light of this need. We have one and a quarter million men under arms at a dollar a day or less. No one would argue that a man who is earning \$3,600 a year with a wife and happy home, who is inducted into the army for a year and earns

Draft #2 5-15-41. 8.

\$360 or less, should continue to get \$3,600 a year because he had averaged such earnings between 1936 and 1939.

Viewed in this perspective, no one can object that the sacrifice which would be required by some corporations through the Treasury proposal of last year is too heavy or is unwarranted.

The need for full utilization of all the nation's economic resources in our common effort justifies the adoption of a real excess profits tax. In my opinion our proposal of last summer is such a measure. This proposal is estimated to yield approximately \$_____.

The Treasury feels, however, that if after re-consideration of our proposal of last year this Committee does not agree upon the necessity for a ceiling limitation on the present average earnings credit, it should seriously consider the following alternative proposal.

First, the provisions of the excess-profits tax which permit a corporation to elect to pay a tax on the invested capital basis should be modified. Under this provision many corporations having huge defense profits,

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but with a large invested capital and a low rate of return, escape excess profits taxation.

One method of attaining this objective is by reversing the order in which the income and the excess profits tax are now computed, and thus returning to the procedure provided in the World War excess profits tax laws. Under this suggestion, recently made to us by the Chief of Staff of the Joint Committee on Internal Revenue Taxation, the excess profits tax would be computed without reference to the corporation income tax and would be allowed as a deduction in computing the corporation income tax. This is the reverse of the present practice.

Changes in the general corporation rates will not then affect the excess profits taxes payable by corporations while at the same time the corporations will be protected against paying a normal tax on the amount due the Government as excess profit taxes.

These large, old, and often overcapitalized corporations, with low earnings records in recent years are benefiting enormously under the defense program.

However, even with the increased profits, their rate of return is low. They either are not subject to the tax or are taxable on only a small portion of their profits. Such concerns, as well as others, may properly be called upon to pay additional taxes on their earnings.

Unless this proposal of Mr. Sten is implemented, however, it has the effect of emphasizing the discrimination in favor of corporations electing to take the income credit. Since the present excess profits tax law embodies in effect the defense-profits principle, the corporate tax burden should be equalized simultaneously with the switching of tax credits, as suggested by Mr. Sten. We suggest this be done by imposing a minimum income and excess profits tax of 40 percent, but (1) with rates graduated downward for small and moderate size corporations and (2) with the qualification that this minimum tax would not diminish the profits of any corporation below 4 percent of invested capital. The many corporations not now subject to defense-profits taxation but earning more than 4 percent would then contribute a minimum tax of 40 percent of their income to the defense program. Merely to switch the credits, however, and at the same time to increase the normal corporate tax substantially would strike a deadly and wholly unnecessary blow at medium size business and those firms having an unusually low capital return.

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There are several precedents for the imposition of minimum taxes of this kind. The Dominion of Canada, for instance, imposes a 75 per cent excess profits tax or a minimum tax of 12 per cent of total profits before income taxes, whichever results in a greater tax. Great Britain also supplements its excess profits tax by a national defense contribution based on income and payable only in those cases where it amounts to more than the excess profits tax.

This plan will, of course, reduce the amount of the excess-profits credit. It will do this less, however, in the case of corporations filing under the average earnings method than for those using the invested capital method. With the 40 per cent corporation income tax rate, the effect of the proposal by the Chief Counsel for the Joint Committee will be to reduce the 8 per cent invested capital credit to the equivalent of ___ per cent in the case of corporations subject to the 50 per cent excess profits tax rate, for corporations using the average earnings method and similarly subject to the highest excess profits tax rate, the proposal would effect a reduction in the credit from 95 per cent of average earnings to ___ per cent.

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In this way the groups now so greatly favored will bear more nearly their proper portion of the taxes.

Let us recognize that what we have today is a defense-profits tax, with a trap-door provision for corporations with big capital structures. In closing the trap-door through which such corporations escape defense-profits taxation, we should not permit corporations with an unusually high return on invested capital to avoid their aliquot share of the tax burden.

July 8, 1949

MEMORANDUM TO THE PRESIDENTQuestion

Shall we adopt -

(a) The war-profits, or emergency-profits, principle, adopted in England and in part in Canada, and which taxes profits above the pre-emergency level, or

(b) The gross-profits principle, adopted in our 1939 Act, which taxes profits above a stated percentage of invested capital, 8% in our 1939 Act, or

(c) A combination of both principles?

Comment

(1) The trouble with the straight war-profits principle is that it will not reach corporations with a high level of profits. It would virtually exempt many of our largest business units which had immense pre-emergency profits, and at the same time, it would burden heavily their more unfortunate competitors which have not done so well in that period. For example, J.C. Penney Company is believed to have made a high return on its invested capital year after year.

(2) The trouble with the straight gross-profits principle is that where the invested capital is large, it will permit

- 2 -

the escape of huge emergency profits. For example, American Car and Foundry Company has a large invested capital, but a low rate of return. It would pay little or no tax even though its profits increased greatly. There are a good many companies which have not made much of a return on the investment for years, but whose profits will be greatly increased because of the defense program.

(3) A combination of the two principles seems essential to a fair workable tax, - one which will tap a maximum of emergency profits and excess profits on a broad base with a minimum of disturbance to business incentive and emergency preparation.

Proposals

It is therefore proposed (percentage figures merely illustrative) -

The tax shall apply to all profits in excess of the rate of return on invested capital which the corporation has actually realized in the pre-emergency period, subject to two qualifications. (1) The company shall be allowed an exemption of not less than 4 percent of invested capital, and (2) in any case, it shall be subject to the tax on what it makes above

- 3 -

10 percent of invested capital. For example, (a) if the company made an average of 5 percent on invested capital in 1935-1939, its profits above 5 percent in 1940 will be subject to the tax. (b) If it made an average of only 2 percent in 1935-1939, any profits in 1940 above 4 percent will be subject to the tax. (c) If it made an average of 15 percent in 1935-1939, the tax shall apply to any profits in 1940 in excess of 10 percent.

This scheme gives greater flexibility than the rigid 1918 Act scheme of 8 percent recently suggested by Senator La Follette, and is closely allied in principle to the 7-9 percent scheme of the 1917 Act. It will obviate much criticism because invested capital is not the dominant factor, but merely the limitation factor upon the use of pre-emergency profits as a standard. By permitting a reasonable capitalization of pre-emergency earnings, it may to a certain extent aid pre-emergency high profit corporations, but by the same token it will save from undue hardship concerns which use invested capital, but which also depend largely upon individual enterprise and skill of management. It will also cause less economic dislocation because it more gradually transforms our

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tax system.

Excess-profits taxation of individuals should be avoided because they are already subject to much higher surtaxes than the taxes applied to corporations. Moreover individuals, unlike corporations, cannot accumulate surpluses free from individual taxation.

We are giving further study to the matter of differentiation between "small" corporations and "large" corporations.

If a general excess-profits tax is enacted, with the steeply graduated rates which you propose, the provisions of the Vinson-Trammell Act with respect to excess-profits should be repealed.

Roy Blough 181
May 15, 1941
11.15 A.M.

EXCESS PROFITS TAX STATEMENT

In response to the kind invitation of your Chairman, it is my desire this morning to discuss with you the special taxation of certain kinds of profits, commonly referred to as excess profits. I shall endeavor to outline the principles which I believe should govern the taxation of excess profits, to indicate respects in which the present law fails to accord with these principles and to suggest various possible remedies which the Congress may wish to consider.

Chapter I - Principles

Any departure from the general taxation of corporate profits reflects a belief that some kinds of profits may be appropriately subjected to heavier taxation than other kinds of profits, either because of considerations of equity, or because the effects on the economy of imposing taxes on such profits would be less harmful than raising the same amount of revenue from other sources.

1. Defense profits

The first type of profits which should, in a period of this kind, be subjected to special taxation comprises the profits which may be reasonably attributed to the

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defense program. Such profits are being made out of the sacrifices of the people as a whole and should be returned to the people in taxes, insofar as may be possible without destroying necessary incentives to produce defense goods.

In a majority of cases it is not possible to distinguish precisely the additional profits due to the defense program, since the effects of defense spending are diffused throughout the whole economic system. It is necessary, accordingly, to approximate profits due to defense by assuming that in general, increases in profits during defense period were due to defense. Some relief can and should be granted where it is clear that such is not the case. Inability to distinguish just what are defense profits should not discourage us from subjecting them to special taxation even at the risk of hitting some non-defense profits.

2. Profits in excess of a return on invested capital

The other kind of profits that can properly be subjected to special taxation comprises profits in excess of a reasonable return on invested capital,

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whether or not this return was earned prior to the period of the defense program. The existence of such profits, while often merited, are in very numerous cases due to monopoly, imperfect competition, or luck and chance, and not to any outstanding service to the public. These excessive profits represent in large part money taken from consumers in excess of the amount necessary to pay for the goods or services. When the imperfections of our economic machine permit this to happen, it is equitable and desirable that the excess profits be subjected to special taxation. Furthermore, at a time when heavy taxes must be imposed they should be levied where they will have the least harmful effects on economic activity. To take an especially large share of the profits in excess of a reasonable return on invested capital will not cause any companies to go into bankruptcy or to reduce the scope of their activities.

I am aware that excessive profits and for that matter the expected defense profits have been so anticipated by the financial community that security prices have become adjusted to them and that the imposition of these special taxes may hit some owners of corporate

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securities harder than others. While we cannot entirely disregard such vested interests, we must remember that no legislation is passed and no progressive step is taken which does not disturb the established interests of innocent people.

I am also aware that the application of the principle of taxing profits in excess of a reasonable return on capital involves difficulties of both theory and technique. I feel sure that we should not allow these difficulties to stand in the way of our seeking to attain the main objective, mainly the special taxation of profits which should be subjected to such taxation.

Chapter II - Defects of the present law

In the light of the principles just stated, I wish to examine the excess profits tax law passed last summer, to see in what respects, if any, it fails to correspond to those principles.

1. Failure to reach large parts of defense profits

The Excess Profits Tax Act of 1940 was a clear expression of Congressional intent that profits growing out of the defense effort should be subject to excess

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profits tax. The law, however, has not achieved that objective. Many corporations that are the principal beneficiaries of the defense effort and that hold large government contracts are paying little or no excess profits tax. Some of these corporations are not only making more profits than they do in normal times but are finding it necessary to expand in order to fill defense contracts.

In the absence of excess profits tax returns an examination has been made of published financial data for certain corporations. One company which, through March 31, 1941, had received \$73,000,000 of defense contracts and whose profits in 1940 were more than 3,000 percent larger than 1939 is subject to no excess profits tax whatever on 1940 earnings. The financial data of one of the large integrated steel companies which has received nearly \$400,000,000 of defense contracts indicate that its earnings in 1940 will be nearly 200 percent larger than in 1939 and that it will not be subject to excess profits tax. It is reported in one of the financial periodicals that only 5 out of 12 large integrated steel companies will be subject to

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excess profits tax on the income of 1940, although it will be borne in mind that the steel companies have in general received huge amounts of defense orders.

These companies escape excess profits tax in whole or in part because of the allowance of a minimum credit of 8 percent of invested capital. This provision was inserted by the Congress not to protect these corporations, but to aid corporations that were small and growing, newly formed, or in a depressed condition, and that needed the safeguard of a minimum untaxed return on invested capital. The law did not distinguish among kinds of corporations and as a result did not either tax the defense profits or adequately protect the corporations needing assistance.

We have been besieged by legitimate requests for relief. An amending bill was passed in March of this year to give such relief and there are still cases not provided for.

2. Excess profits other than defense profits not taxed

Another serious shortcoming of the 1940 excess profits tax law is that profits in excess of a reasonable return on invested capital are not subjected to the tax unless such profits also represent an increase over the profits

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of the base period. For example, one company which earned during the base period an average of approximately 37 percent on its present invested capital will be free from the excess profits tax on income in any year equal to approximately this 37 percent (the average earnings credit being only 95 percent of the base period earnings) and will be taxable only on such increases in income as it may enjoy. The failure of the law to reach a large portion of excess profits was due to the provision of a credit for every corporation equal to 95 percent of its base period earnings, regardless of the size of those earnings in relation to its invested capital.

May 15, 1941
2:32 p.m.

HMJr: Hello.

Operator: Miss Tully.

HMJr: Hello.

Grace Tully: Hello.

HMJr: Grace?

T: Yes, Mr. Secretary.

HMJr: Good evening.

T: Good evening, sir.

HMJr: Good afternoon

T: (Laughs)

HMJr: You'll be seeing the President, wont you, sometime this afternoon?

T: Yes, I expect, probably about four thirty or quarter of five.

HMJr: Good. Well, now have you got a pencil?

T: Yes sir.

HMJr: I'm beginning to see daylight on our tax statement.

T: Yes.

HMJr: And we'll surely have it ready by ten tomorrow morning.

T: Yes.

HMJr: We've been working day and night. I'll either send it over or bring it over, whichever is easier for him.

T: Yes.

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HMJr: You might remind him I have not discussed taxes (Laughs) with him since July 8, 1940.

T: I see sir. All right.

HMJr: And that we go on the Hill Monday. They postponed it until Monday.

T: Till Monday? Yes sir.

HMJr: Doughton was wonderful about it. He did it in a way that there could be no - well, he didn't let out that we weren't ready.

T: Yes, I see.

HMJr: But when we go up Monday, I want to have Sullivan to be able to say that he's talking.

T: Yes.

HMJr: Both for the President and for myself.

T: Yes.

HMJr: And if the President could give it a little time some time tomorrow morning, why, it would be very helpful to me.

T: All right, sir. Let me call you back later in the afternoon or early evening and let you know.

HMJr: I - I would say you got the picture.

T: Yes.

HMJr: I counted it Monday, deadline, which we have now - I mean we could put down - But you will surely come Monday, and I said positively.

T: Yes.

HMJr: It's our fault over here.

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T: Uh huh.

HMJr: And if the President will be a little generous, why maybe he could help me get by.

T: All right, Mr. Secretary, I'll give him the message.

HMJr: Thank you.

T: All right, sir.

May 15, 1941
3:00 P.M.

RE TAXES

Present: Mr. Magill
Mr. Shoup
Mr. Gaston
Mr. Foley
Mr. Sullivan
Mr. Helvering
Mr. Kades
Mr. Kuhn
Mr. Blough
Mr. Greenbaum
Mr. Knollenberg

H.M.Jr: Did you have some soup?

Blough: Yes, I am all right.

H.M.Jr: I think you have got a little more color.

Blough: There has been no time for comedy, I will assure you. This is the present draft.

Magill: Are you going to make this statement, John?

H.M.Jr: I will answer you. Yes. Is that right, John?

Sullivan: I understand so.

Magill: I would have put in a couple more adjectives if I had known that, John.

Gaston: Here is mine. I didn't consult Roy at all.

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H.M.Jr: Now let's see. I have got Roy Blough at eleven fifteen A.M. I have got you on a time schedule, Roy.

Now let me just get this. This is yours, Herbert?

Gaston: Yes. I just gave some introduction along the background line, the need for --

H.M.Jr: And have you got something, Ros, too?

Magill: Yes, sir. I wrote the beginning of this business that - of Blough's.

Blough: His is in with mine.

Magill: I wrote it with Blough.

H.M.Jr: It is melded in here?

Magill: That is right.

H.M.Jr: But this is separate?

Gaston: That is separate.

Magill: It may be that we have covered the same things. We may want to cut out some some where.

H.M.Jr: And this is you, Herbert, this one?

Gaston: Yes.

Magill: May I ask who wrote your other statement, Mr. Secretary? Did you do it yourself?

H.M.Jr: Which one?

Magill: The one that you had when you appeared before the Committee first. Was that this same group?

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H.M.Jr: Who did that for me?

Blough: Ferdie.

Kuhn: Roy Blough and lots of people were in on it.

Magill: I thought that was an awfully good piece of work.

H.M.Jr: What made you think I did it?

Magill: Because it was such a good piece of work.

H.M.Jr: I don't know. How many people were in on that?

Kuhn: Gee, I don't know.

H.M.Jr: You know I never write a statement of my own.

Magill: Tut, tut, tut.

H.M.Jr: Who was it? I don't know who it was.

Gaston: Ferdie did most of it.

Magill: It was an awfully good job of writing, whoever did it.

H.M.Jr: Well, didn't you recognize that New York Times touch? (Laughter)

Magill: That is the paper you love to touch, isn't it?

H.M.Jr: Now, having identified all these things, I will read Herbert's first.

"My purpose today is to discuss with you the problem of corporate taxation in the present emergency. What I shall have to say is supplementary to the statement made by Secretary Morgenthau when the current hearings

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were opened and to the suggestion later laid before you on behalf of the Treasury Department."

You don't say anything about Eccles or Henderson here. (Laughter)

Gaston: No, we are not supplementing them.

H.M.Jr: Oh.

"Before attempting to review the present provisions of law with respect to corporation taxes and before offering suggestions in this field, I want to say something about the situation which confronts us and makes urgently necessary the work your committee is undertaking.

"I don't think we can make any proper approach to our problem without bearing constantly in mind the fact that we are in the midst of a very serious national emergency. We are undertaking as a whole people to exert a maximum of effort for the national defense. We face the urgent need of great additional revenue to finance that effort.

"The Treasury is called upon to meet expenditures greater than have ever been made in the nation's peacetime history, and probably greater than at any time in our history, in peace or war. At such a time we can not expect to rely on normal sources of revenue or be content with revenue in normal amounts. We must adopt extraordinary measures to deal with our extraordinary situation.

"We can not expect to devise a painless tax bill, nor one that is free of all inequities. That is not possible at any time, and it is certainly not possible in the light of our

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present need. All that we can hope to do is to minimize inequities and to distribute the burden as fairly as we humanly can.

"The situation calls for sacrifices. As Secretary Morgenthau has already told you, we have had unmistakable evidence that the people are willing to make sacrifices according to their ability. As we call upon them to make those sacrifices we should again, as far as humanly possible, measure the sacrifices we call upon them to make according to their ability to make them. It seems to me permissible to remind ourselves that outside the tax field greater sacrifices are being asked and must be asked. There is no basis of comparison of the sacrifice of those who are asked to exchange the comforts of a job and a home for a soldier's pay and a soldier's hardships with the sacrifice of those who are asked to pay even drastically higher rates of tax.

"To obtain the revenue we must have for sufficient support --"

- Magill: May I suggest that you change "comforts" to "security."
- Gaston: Yes.
- H.M.Jr: I think "comforts" has a connotation.
- Magill: I think "security" is a better word.
- H.M.Jr: All right.
- Gaston: That is all right.
- H.M.Jr: "To obtain the revenue we must have for sufficient support of our defense effort we need to increase substantially the yield of our corporate taxes. We have already suggested and the committee is

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considering heavy increases in taxes upon individuals. On the basis of ability to pay, we can fairly call upon corporate earnings to bear a larger share of the load.

"It is in the light of these considerations and, bearing in mind that it is the Treasury's responsibility to make suggestions and to analyze the effects of tax laws and proposals for changes in the law, while it is the committee's responsibility to prepare tax bills, that I now wish to offer some comment on the existing law and suggestions as to how additional revenue may be obtained."

Well, that is a good start. Now, Mr. Blough, if you will read yours, please, we will be glad to listen.

- Blough: Now, this starts out --
- H.M.Jr: Excuse me. Shoup, has somebody given you the background of what happened this morning?
- Shoup: Yes, thank you, Mr. Secretary. I have all that, I think.
- H.M.Jr: So I needn't bother?
- Shoup: Yes. I know what is back of it.
- H.M.Jr: You know the background as just one word, Guy, headache. You (Shoup) are all right?
- Shoup: Yes.
- H.M.Jr: You can go right along with us.
- Shoup: Quite.
- H.M.Jr: Fine. Did you come down by plane?

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Shoup: Yes, sir. I came down this morning.

H.M.Jr: Well, I appreciate it.

Blough: This is the eleven o'clock draft plus a page or two at the beginning by Mr. Magill, plus suggestions and revisions by Magill and Shoup, plus a tail end that wasn't on at eleven o'clock.

H.M.Jr: A tail end by Blough.

Blough: Blough, Shoup, and Magill.

"Your Committee is now engaged in formulating changes in our tax system to accomplish two main objectives: (1) to provide the total revenues that we need to enable us to finance the great defense expenditures that we are committed to make; and (2) to assist in maintaining the economic health of the nation. Our people know that we are faced with a great challenge. They know that great sacrifices must be made and they are prepared to make them. They rely upon us so to plan our financial program that, however severe its burdens may have to be, they will rest fairly and justly upon all individuals and all businesses.

"The tax program which you will propose will necessarily consist of many elements. Any one tax, viewed by itself, may appear to be stringent and oppressive. All must be viewed, however, as parts of a whole. These are war times. Taxes that would not be proposed in peace times are a necessity now. We cannot give effect to all those niceties of exemptions and saving clauses that are appropriate to easier occasions but today will defeat our ends.

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"I have been asked particularly to discuss the excess profits tax, first enacted in the fall of 1940. Our experience with it is still limited, for many of the returns of the largest corporations have not yet been filed. Enough have been filed, however, to convince Treasury officials in charge of administration that important changes in the law must be made in the interests of fairness."

H.M.Jr: Excuse me. Treasury officials in charge of administration?

Magill: Well, I put that in because I thought that was a - if you want Internal Revenue officials, but I thought it would be well to let them understand that these suggestions were coming from the grass roots, if you like, from the people who are actually in charge of administering the law and that they were not somebody's academic theories from the top, somewhere.

H.M.Jr: Like me?

Magill: Yes.

H.M.Jr: O.K.

Magill: Like Shoup.

Shoup: How true.

H.M.Jr: All right.

Blough: "We are collecting large sums by means of this tax but the profits of a good many other business firms are going entirely untaxed, although those profits appear excessive by any standards I know how to apply. Here is certainly a place to broaden the base. Surely the skill of this Committee and its experts is adequate to the task of bringing within the tax the known cases of excessive business profits."

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H.M.Jr: Excuse me. I like that. This is the place to broaden the base, and not on the poor fellow. That is good.

Sullivan: I didn't get all your remarks.

H.M.Jr: I said, I like this. This is the place to broaden the base, rather than doing it on the poor man. I mean, that is what this says.

Sullivan: Yes, I understand.

H.M.Jr: I say I like this. I mean, there has been all the talk about broadening the base, but whenever they talk about broadening the base they mean increase the taxes on the poor man.

Blough: "I want first to outline the principles which I believe should govern the taxation of excess profits; second to indicate respects in which the present law fails to accord with those principles; and third, to suggest various possible remedies which the Congress may wish to consider.

"I - Principles: Under present conditions some kinds of profits may be appropriately subjected to heavier taxation than other kinds to get a fair distribution of the burden and to avoid unfavorable effects on the defense program or on business in general that would result if the revenue had to be raised in other ways."

H.M.Jr: Just one second please. O.K.

Blough: That is Shoup. (Laughter)

"1. Defense profits: The first type of profits which should, in a period of this kind, be subjected to special taxation comprises the profits which may be reasonably attributed to the

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defense program. Such profits are being made out of the sacrifices of the people as a whole and should be returned to the people in taxes, insofar as may be possible without destroying necessary incentives to produce defense goods.

"In a majority of cases it is not possible to distinguish with perfect precision the additional profits demonstrably due to the defense program. The effects of defense spending are diffused throughout the whole economic system. It is necessary, accordingly, to determine profits due to defense by assuming that in general, increases in profits during the defense period are due to defense. Some relief can and should be granted where it is clear that this is not the case. Inability to distinguish just what are defense profits should not discourage us from subjecting them to special taxation even at the risk of hitting some non-defense profits."

H.M.Jr: Who is this?

Blough: I guess this is mostly Blough, with revisions by Magill and the others.

"2. Profits in excess of a return on invested capital: The other kind of profits that can properly be subjected to special taxation are profits in excess of a reasonable return on invested capital, even if this return was being earned in the years prior to the defense program. The existence of such profits, while often due primarily to good management, are in very numerous cases due to monopoly, imperfect competition, or luck and chance, and not to any outstanding service to the public. These excessive profits represent in large part money taken from consumers in excess of the amount necessary to produce the goods or services. When the imperfections of our economic machine have permitted this to happen, it is equitable and

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desirable that the excess profits be subjected to special taxation. Furthermore, at a time when heavy taxes must be imposed they should be levied where they will have the least harmful effects. To take an especially large share of the profits in excess of a reasonable return on invested capital will not cause any companies to go into bankruptcy or withdraw from business."

H.M.Jr: Just a second. O.K.

Blough: "I am aware that excessive profits and for that matter the expected defense profits may have been so anticipated by the financial community that security prices may have become adjusted to them to some degree. The imposition of these special taxes may hit some owners of corporate securities harder than others. We cannot entirely disregard such vested interests, but we must remember that no legislation is passed and no progressive step is taken which does not disturb the established interests of some people. We submit that vested interests in high profits are entitled to no more protection than an individual's interests in a large salary, now subject to a heavy tax. These are times of war and changes must be expected."

H.M.Jr: That sentence takes care of Foley, doesn't it?

Blough: That is Magill.

H.M.Jr: But I mean, that is what Foley has been hollering about. I mean, about his twenty-five hundred dollar contribution. (Laughter) It is all right.

Blough: "I am also aware that the application of the principle of taxing profits in excess of a reasonable return on capital involves difficulties of both theory and technique. I feel sure that we should not allow these difficulties to stand in the way of our seeking to attain

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the main objective, mainly the special taxation of profits which should be subjected to such taxation."

That doesn't make much sense, that couple of lines.

- H.M.Jr: Will you make a note, Roy - you may hit it later on, but these tax economists - if you haven't said something about the Defense Savings Bonds plus taxation taking - skimming the cream off of the savings. If you haven't got something on that.
- Blough: That is not in this draft, no.
- H.M.Jr: You tax economists give me something on that. Do you follow me?
- Shoup: Yes, I think I do.
- H.M.Jr: I mean, it is a combination of these high taxes plus what we take for Defense Savings Bonds, which is the Treasury's contribution toward keeping - well, to attempt to keep us from having inflation. I think if we take - well, you see if it is - the taxes would be what, nine or ten billion, John.
- Sullivan: Nine billion two plus the three five, is twelve seven.
- H.M.Jr: Let's call it thirteen. It is safe to say that we ought to pick up what, three or four billion in Defense Savings Bonds?
- Kuhn: Oh, I hope more.
- H.M.Jr: Let's say thirteen and four are seventeen. I don't know whether I want to use any figure but I want to throw that at you, that we might

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pick up seventeen or eighteen billion, and are we doing our part in taking out of circulation this money, from spending, you see.

Shoup: Yes. You might not want to use definite figures, Mr. Secretary, but the general idea is all right.

H.M.Jr: When we get through, if I could talk a little bit and then argue with you whether we do or don't. If it could be properly worded I would sort of like to get that in. We here in the Treasury feel that is our responsibility toward keeping away from a runaway market. Will you keep it in mind?

Shoup: Yes.

H.M.Jr: I have never seen it just put that way. There is a definite responsibility on the Treasury to do that, I think.

Shoup: Oh yes, surely.

H.M.Jr: If we could word that.

Shoup: We can certainly give the idea of the responsibility. I would want to be a little cautious about the exact figures.

H.M.Jr: True, but I think it would come in the beginning under principles, aims.

Blough: Probably earlier in the statement.

H.M.Jr: Yes, in the beginning. I mean, what are the aims, what are we trying to shoot at? It would certainly be

Helvering: You want to guard against the possibility of those fellows on the Hill saying, "If you are

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going to get this money, maybe this tax need not be so high."

H.M.Jr:

Well, I don't know but when we get through, I would like to have these economists, these tax economists - I would like to hear them argue amongst themselves, what proportion should we take out in savings and in taxation. I mean, if it is a ninety billion dollar country how much of that - what percent ought we to take out. What shall we aim for?

Now, we may miss it. Should we take fifteen, twenty percent, twenty-five percent? What should we attempt to take, you see. I have never seen that put by anybody from here. I don't know, maybe it has been written on. I am sure it has. But I mean, what is a good economy, how much should be taken off when such a large proportion of the goods we are manufacturing are being manufactured to kill somebody and not for productive purposes. They all become frozen. You have got your excess earnings going to your workers to be spent and how much of that should we try to take away from them. What?

Shoup:

It is a very real technical problem, Mr. Secretary. The problem can't be answered by any one percentage. It is going to vary with time, but I would like a chance to discuss it.

H.M.Jr:

We haven't set it, and I think it is an awful good time to say it.

Shoup:

But we don't want to commit ourselves to any figure right now.

H.M.Jr:

We can talk theory. I would like to argue and listen.

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Blough: He just finished writing a book about that, Mr. Secretary.

H.M.Jr: Did he?

Blough: Wasn't that what it was about?

Shoup: A piece of a book, the beginning.

H.M.Jr: Is it published?

Shoup: Not quite yet.

H.M.Jr: Then how should I know. (Laughter) You have got inside information.

Shoup: I will bring you the first copy, Mr. Secretary.

H.M.Jr: Thank you. Then I am talking to an expert. When we get through will you run a little forum on it?

Shoup: I will be very glad to.

Blough: Page six.

"II - Defects of the present law: In the light of the principles just stated, I wish to examine the excess profits tax law passed last summer, to see in what respects, if any, it fails to correspond to those principles.

"1. Failure to reach large parts of defense profits: The Excess Profits Tax Act of 1940 was a clear expression of Congressional intent that profits growing out of the defense effort should be subject to excess profits tax. The law, however, has not achieved that objective. Many corporations that are the principal beneficiaries of the defense effort and that hold large government contracts are paying little or no excess profits tax. Some of these

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corporations are not only making more profits than they do in normal times but are finding it necessary to expand in order to fill defense contracts.

"In the absence of complete --"

- H.M.Jr: Excuse me. When you say that "necessary to expand in order -" I thought a fellow - that is something wrong that they are doing. I don't see why you have got to leave it in.
- Blough: All right.
- H.M.Jr: As though it was wrong. What?
- Knollenberg: I agree with that.
- Magill: If he can put in "and" instead of "but."
- H.M.Jr: I don't see why it is necessary. These corporations not only making more profits than they do in normal times - do in normal times, period.
- Blough: Why not strike the sentence?
- Foley: What he is saying is that business is so good that they are building new plants and they are expanding their activities.
- Knollenberg: Then they will come back and say, "The reason we are making more profits is because we are expanding, which we are treating as capital expansion. After the war is over, then we are going to lose as a result of that." I think the Secretary is right on that. That is just the wrong kick.
- H.M.Jr: It hit me that way the first time. Put a question mark, will you?

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Blough: Why not strike the sentence? I think I agree with you.

H.M.Jr: Then let's strike it out.

Blough: "In the absence of complete excess profits tax returns, an examination has been made of published financial data for certain corporations. One company which through March 31, 1941, had received over 70 million dollars of defense contracts and whose profits in 1940 were more than 3,000 percent larger than 1939 is subject to no excess profits tax whatever on 1940 earnings. The financial data of a large steel company which has received over \$250,000,000 of defense contracts indicate that its earnings in 1940 will be nearly 200 percent larger than in 1939 and that it will not be subject to excess profits tax. It is reported in one of the financial periodicals that only five out of twelve large integrated steel companies will be subject to excess profits tax on the income of 1940, although it will be borne in mind that the steel companies have in general received huge amounts of defense orders."

I don't mean to jump on the steel companies particularly. Maybe it sounds too much like that and we ought to --

"These companies escape excess profits tax in whole or in part because of the allowance of a minimum credit of eight percent of invested capital. This provision was inserted by the Congress not to protect these corporations, but to aid corporations that needed the safeguard of a minimum untaxed return on invested capital. The law did not distinguish among kinds of corporations and as a result neither taxed the defense profits nor adequately protected the corporations needing assistance.

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"2. Excess profits other than defense profits not taxed: Another serious shortcoming of the 1940 excess profits tax law is that profits in excess of a reasonable return on invested capital are not subjected to the tax unless such profits also represent an increase over the profits of the base period. For example, one company which earned during the base period an average of approximately 40 percent on its present invested capital will be free from the excess profits tax on income in any year equal to approximately this 40 percent and will be taxable only on such increases in income as it may enjoy. The failure of the law to reach a large portion of excess profits was due --"

There probably should be a paragraph there.

"The failure of the law to reach a large portion of excess profits was due to the provision of a credit for every corporation equal to 95 percent of its base period earnings, regardless of the size of those earnings in relation to its invested capital."

That may not be enough there. I don't know.

H.M.Jr: Well, go ahead.

Blough: "III - Remedies: Revisions of the excess profits tax to be considered adequate, must eliminate the two gaps which I have pointed out are present in the existing law. The exemption of defense profits made by firms that have had large dormant invested capital can be stopped by reducing the eight percent credit of tax-free earnings on invested capital. The gap resulting from allowing an unlimited average earnings credit can be reduced by requiring all corporations earning more than a stated percentage on their invested

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capital to pay an excess profits tax, regardless of their average earnings. It will be recalled that these were the basic elements of the Treasury excess profits tax proposals of 1940."

I discovered when I got through that I hadn't made any recommendations, so I added a recommendation in pen at this point.

"And it is this plan, with modifications dictated by experience, that we suggest.

"In that proposal corporations were to be allowed --"

H.M.Jr: Excuse me. Do you go along on that, Shoup?

Shoup: Yes, sir.

Blough: "In that proposal corporations were to be allowed tax free their earnings during the base period, but with a minimum and a maximum. The minimum was four percent of invested capital with six percent allowed on the first \$500,000. The maximum was ten percent. Thus, under the Treasury plan a concern which earned five percent during the base period would be allowed to continue to earn five percent free of tax. The concern which earned only two percent during the base period would be permitted to earn four percent free of tax. The concern which earned fifteen percent during the base period would be allowed to earn ten percent free of tax. This combination of a tax on defense profits and a tax on excess profits was calculated to reach a large proportion of both kinds with a minimum of hardship.

"Under the Treasury proposal it was recognized that if businesses were to be expanded and investors were to put new money into corporations,

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an opportunity must be allowed to earn a substantial rate of return on new capital. The plan allowed an eight percent return, regardless of the earning experience during the base period on old capital. If the Treasury plan had been applied in the examples previously presented, the tax results would have been quite different. The corporation which had a very high rate of return on its invested capital in the base period would have paid excess profits tax on half of its income instead of on about one-seventh under the present law. One of the examples of a corporation which had poor earnings during the base period would have paid excess profits tax on over one-third of its income and the other on about one-fifth of its income instead of both being entirely exempt.

"Even with these tax increases, however, the Treasury plan would have failed to apply special taxation to substantial amounts of defense profits received by the corporations with poor earnings during the base period. To meet this defect we would suggest revising the 1940 proposal to provide that where the average earnings of the base period were of the base period were less than the minimum of four percent, the excess profits tax should be applied at a lower rate, possibly ten percent, to the current profits in excess of the base period earnings but not in excess of four percent on invested capital."

H.M.Jr:

Wait a minute, explain that.

Blough:

Possibly the corporation didn't earn anything in the base period, had zero. It had an invested capital of a million dollars. Under the Treasury plan we would have allowed it roughly fifty thousand dollars of credit and it could deduct that fifty thousand dollars

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from its current earnings before it would have any taxable profits.

Now, this proposal would say, on that fifty thousand dollars, minimum credit over and above what they earned during the base period, which was zero, we will impose a ten percent tax.

H.M.Jr: On the fifty thousand?

Blough: On the fifty thousand.

H.M.Jr: Couldn't you say "for example," and then put that example in?

Blough: I am sure we can make that clear, Mr. Secretary.

H.M.Jr: I think you could. I think you could spell it out just like that.

Blough: Surely we can do that.

H.M.Jr: Spell it out just like that.

Blough: Spell it out with an example?

H.M.Jr: Yes.

Blough: "This special rate of tax would subject all increases in profits during the defense period to some special taxation while at the same time the rate would not be high enough to cause undue hardship to concerns whose increase in earnings over the low rate received during the base period did not reflect defense profits.

"We would suggest also that the rate allowed on new capital --"

H.M.Jr: Excuse me. Isn't that going to be graduated by size?

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Blough: I come to the graduation in just a minute.

H.M.Jr: All right.

Blough: "We would suggest also that the rate allowed on new capital be the same as the maximum rate allowed on outstanding capital, namely, ten percent."

Now, that is a change from the other and Mr. Shoup and I both prefer the ten to the eight if we can get it.

"It should be recognized that any maximum return on capital must be a somewhat arbitrary figure because businesses differ widely with respect to the degree of risk they face. Accordingly, it is desirable not to set too low a maximum rate.

"Furthermore, it would be desirable to change the type of rate graduation from that existing in the present law, so that a relatively low rate of tax will be applied to the slightly excessive profits and the higher rates applied to profits that are more clearly excessive."

That is, if a concern had a four percent rate on an income, the first percent above would be much lower than the higher one.

H.M.Jr: I would like this last part, because it is a little new to me, argued a little bit, the pros and cons, the last two pages.

Blough: That of course, has the whole meat of the recommendation.

Magill: You have got to have a conclusion on this, too, Roy.

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Blough: Oh yes, it isn't quite done.

Magill: It ought to be finished off in the same style in which it started.

H.M.Jr: What is the matter with this, Roswell? What can be the criticism? What can the U. S. Chamber of Commerce say is the matter with this?

Magill: Oh, I would think they would go right to the center of it and say that any tax which has as its base some rate of earnings on invested capital is bound to be a bad tax. They will say, too, I should think, to emphasize the degree of risk element, that some corporations in order to get money invested in a business at all have to give a higher return and other corporations are so stabilized, like Public Utilities, that they can get along on a low return, that this type of tax doesn't adequately distinguish between them.

Then I think they will make the point we discussed this morning, that undoubtedly there are plenty of investors who have bought stocks in some of these companies at a price which doesn't yield them an excessive return on their investment. The company, however, will now be confronted with a large excess profits tax and thus the return to the individual stock holders will be cut down.

H.M.Jr: That isn't what I mean, Ros. I am sorry. This last two pages.

Magill: Oh, the last two?

H.M.Jr: Yes. This is this new thing. This suggestion for correcting the last year's Treasury plans. I mean, this is entirely new to me.

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- Blough: That special ten percent tax, for example, on that bottom bracket.
- H.M.Jr: Yes.
- Sullivan: I don't think there will be any criticism of that at all, Mr. Secretary. United States Steel and American Car and Foundry will --
- H.M.Jr: You think this last --
- Sullivan: That part of it I heartily agree with, yes.
- Foley: When they realize our plan, I think it will be all right.
- Sullivan: There isn't any doubt about that in my mind.
- H.M.Jr: You think that takes care of it?
- Sullivan: Of the invested capital fellow who is getting away with murder, yes.
- H.M.Jr: If I understand it correctly, if he is below the four percent he doesn't even come in on that and then he is going to have to pay ten percent --
- Blough: Of the increase in earnings over his base period, up to the four percent.
- H.M.Jr: Up to the four?
- Blough: Above that he pays a standard rate, what everybody else pays. On the new money he will be permitted to earn ten percent.
- Magill: Both of those, I think, are liberalizing provisions as anybody would regard them. I shouldn't think there would be a very serious attack on either.

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Blough: One is not a liberalizing provision.

Sullivan: The first one isn't liberalizing, that is tightening up.

Magill: Well, it is liberalizing in this, that your rate is low. You are advocating an excess profits tax graduated from a comparatively low rate to the higher rates which we have today. You are not advocating that this tough rate which you have now be applied down at the bottom of the ladder.

Now, as that will actually work out, I should think somebody like Alvord will think, "Well, that is fine because I can use that as a lever to urge that the whole rate scale be liberalized and modified, lowered."

Greenbaum: How do you justify your ten percent on the new capital as compared with the present on that basis, Roy?

Sullivan: You can't do that with the big company who gets his money for two and a half or three percent.

Greenbaum: The Secretary is asking you whether you would be picked on --

Sullivan: You are going to be picked on there.

Greenbaum: For your new money.

Sullivan: And I don't see why we don't go back to our original proposal of last summer which was that on the - which was a graduation allowing them a hundred percent on the first - on borrowed capital that didn't bring the total assets up over five hundred thousand and then sixty-six and two thirds on further borrowed capital that didn't bring the total assets

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above a million and then one third above that, because it worked out that those were about the rates that companies of that size would have to pay for new money. You recall that, Ros?

Magill: Yes.

H.M.Jr: Well what --

Magill: Carl, you had better defend this because this is really your baby.

Shoup: Ten percent?

Magill: Yes.

Shoup: Simply this, that a system of private enterprise is not going to function unless it has a chance to get not only what we think of as a fair interest rate, but a good deal higher in order to compensate for the risks involved.

Now, a good many businesses will not need to get as high as ten percent, true, but we are in a position, I think, where if we are going to have the system function we have to let some concerns and some businesses get somewhat more, perhaps, than they would really need in order to keep going so that we may be sure that the bulk of a system keeps on running.

Let me put it this way. I think that the bulk of new capital needs a promise of at least ten percent if it wins, because its chances of winning are often rather slim or at least somewhat doubtful, so that I should say the bulk of new capital will not go into business unless it has the chance of keeping ten percent if it wins out. I should,

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as a matter of fact, be inclined to put the percentage higher, make it even around twelve percent, but I recognize that there is a good deal of difficulty in getting that point of view across and I am not trying to be dogmatic about a particular percentage up in that level. I think that the suggestion with respect to borrowed capital is certainly sound.

I would only say once we have got our invested capital concept straightened out, then let's be as liberal as we can with new capital in order to keep the system functioning.

Blough: There certainly will be criticism about it. There was criticism last summer that the new capital would get eight while the old might get four or five or six. I don't think it was a valid criticism, but there are people who differ.

H.M.Jr: Well, of course I never heard Shoup say this before, but what Shoup said on new capital, allowing them ten percent - I mean, it seems to me that there is a tremendous amount of discouragement amongst business and if on the new capital we allow them to make ten percent profits, it does give them some inducement to go in. I think they need it pretty badly and that wouldn't bother me, to let the new money have it, because if they lose it, they take a hundred percent loss.

Shoup: We give them no refund.

H.M.Jr: And we don't let them take any allowance, do we, in their returns?

Shoup: Practically not, because if a business really loses, the business goes out of existence.

H.M.Jr: So that part wouldn't bother me.

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Knollenberg: Well, but you give them ten percent on new money in an old enterprise and in that event if it lost out, it would just go as an offset against the income of the previously invested capital. You are thinking only of a new business, if what you said would be true, Mr. Shoup.

Shoup: It is true that what I said would not be universally always true. In other words, occasionally they would get a reduction in the form of offset against profits but depending upon how big the expansion is.

If the Union Bag and Paper's new terrific expansion plant went wrong, the profits they could make on their old big plant wouldn't be enough to take care of it so it is a case of knowing how far to go in giving, shall we say, too much to some people in order that the bulk of the enterprise system gets what it needs in order to function.

Sullivan: I would like to repeat a question I asked you before, Carl, that may clarify this somewhat for the group here. Suppose Glenn Martin decides to issue another - have another issue of stock. The person who buys that stock is allowed - isn't allowed ten percent on his money. That merely goes to sweeten the entire dividends for all classes of stockholders, does it not?

Shoup: True.

Sullivan: Then what added inducement is that to Mr. Knollenberg, who is wondering whether or not he should buy some of this new Glenn Martin stock?

Knollenberg: That is my point.

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Shoup: Well, as far as Mr. Knollenberg would be concerned and his supply of new capital to the corporation, not merely the purchase of outstanding stock, but the supply of new capital, we could only say that after all, once he gets into the corporation he is in any case merged with all the other stockholders and that is the terms on which Mr. Martin was asking him to come in.

Are we to assume anything differently in our fixing of the law? If indeed he is to give you some special preferential stock or something, that would be a different matter. He is really asking you to come in and share the risks of everybody else and I can't see that we can do much more than accept that premise.

Blough: Well, his point, Carl, is this. Suppose a concern has only been making - is only permitted to make five or six on a hundred dollars or a hundred million dollars of capital and now they are issuing another dollar and selling it to you or somebody. That added dollar will, it is true, add the opportunity to earn ten cents more, but that will be distributed among all of them and will not go to this new investor.

Shoup: Quite true. All I am saying is that suppose there were no excess profits tax at all. It is still basically true that what Mr. Martin is asking you to do is to pool your dollar with whatever risk all the other dollars undergo.

Blough: Isn't there another side to it, that the Glenn Martin Company wouldn't be disposed to risk the rest of its assets by expanding and going out and getting new money to expand unless it can see the opportunity of earning ten percent on the new money. Not only is it the question of the investors, it is the

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question of the company that is doing the expanding.

Shoup:

You might put it this way, that Mr. Knollenberg turned his money into the company for a new share of stock, whereupon that money merges with all the other companies' money and it is the company's money which is now up for consideration, and it wants to know what shall it do with its money and I take it that the company decides on the basis of its total status as a company, that it is no more concerned now with you (Knollenberg) than it was with me or any other stockholders, and that it is constantly facing the question of whether to expand or contract with the money that it has, wherever that money may have come from.

I would certainly agree that the plan that we have in mind here doesn't give the full protection to Mr. Knollenberg in his hypothetical case that I would like to give if we had an ideal system. A perfectly ideal system I would even trace back to each individual stockholder but I take it we can't even talk of that for the moment.

Gaston: Maybe, carrying it one step further, the ideal system would abolish the corporation. (Laughter)

Shoup: Well, very possible, but since we have to take the corporation as one of these things we have got, the only question is to --

Knollenberg: Abolish it as a taxing unit.

Gaston: Yes.

Shoup: Does the ten percent give us any better chance for expansion than six or eight? I would argue yes, even despite the case you cite.

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H.M.Jr: Let me just stop this one minute. Let me continue it.

Is everybody happy about the new suggestion about how to get the American Car and Foundry type who make an increased profit but who don't reach the four percent, is everybody happy about that? Everybody is happy about that?

Sullivan: That is right.

Shoup: That is right.

H.M.Jr: And ten percent is enough?

Blough: We would like to examine that, Mr. Secretary. I think ten percent is probably about right.

H.M.Jr: Then the only other thing that is left is this question of new capital, is that right?

Blough: No, the last paragraph indicates that we go back to the old Treasury rates. That is not a new suggestion, but it is different from the present law. It is the rates under the Treasury plan and they don't become so severe so quickly. There will be so much more profit subject to tax that it won't be necessary to have such severe rates in order to secure the desired revenue.

H.M.Jr: What are the --

Magill: That proposal is just clearly right, that last paragraph.

Sullivan: Twenty-five percent on that amount of excess profits tax net income which does not exceed fifteen percent of invested capital. Forty percent on excess profits tax net income between - which equals between fifteen and thirty percent

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of invested capital and fifty percent on the excess profits tax net income above that.

H.M.Jr: That was last summer's?

Sullivan: That is last summer's.

Now, the best guess that Mr. O'Donnell can give that you asked for on the yield on 1941 calendar liabilities under our tax proposal last summer, where that rate is a billion, a hundred and nineteen million under the old Treasury plan as against a billion and twenty-five million under the present law.

H.M.Jr: The other one would be a little bit more.

Sullivan: A hundred and sixty-five million dollars more for the calendar year, which would mean about eighty million - an increase of eighty million for the fiscal year so we will have to change those rates. They will have to be higher than that because we have got to get at least our four hundred million dollars.

H.M.Jr: Well, that doesn't take into account the ten percent on the earnings below the first four.

Sullivan: No, it does not. I wouldn't expect that would amount to a great deal. There aren't a very large number of those corporations there, Roy?

Blough: It won't be a heavy yield, no.

H.M.Jr: Well, I think that something - aren't you going to say something about the rates, what we are talking about, or are you just going to leave that to the committee?

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Sullivan: No, I think it should be in there if you are going to do it, because we will have to state what the yield is and we will have to have some estimates on it.

Blough: We didn't get entirely done. I am sorry.

Magill: Well, certainly if you are going to this kind of a system, the rates ought to be in the terms that they were in the proposal last summer. You - it would hardly be justifiable to have rates in terms of the present law.

Blough: I certainly would think so. In fact, we were considering recommending that kind of rates even under the existing law.

H.M.Jr: Well, and it is very easy to adjust those rates up if they want more revenue.

Sullivan: It can be done.

Blough: It would seem that the real problem is whether the Treasury wants to recommend in essence its old plan.

H.M.Jr: Well, let's put it this way. Have you got anything better?

Blough: I have nothing better.

H.M.Jr: Have you, Shoup?

Shoup: No, sir.

H.M.Jr: Have you?

Magill: No.

H.M.Jr: Do you want to say anything?

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Greenbaum: Is American Car and Foundry the seventy million one?

Blough: Yes.

Greenbaum: Now, the statement of facts that you give on page six in regard to that where you show they received seventy million and it was three thousand percent larger than the preceding year, and it was not subject to any excess profits tax, then when we come out with a proposal that only subjects half its income to the excess profits tax, isn't that - isn't that true?

Blough: It is less than half.

Greenbaum: Isn't that less than half way as far as our proposal goes then?

Blough: That is why we proceeded in the next paragraph to say the proposal doesn't really take care of the whole situation. We should have a supplementary tax in which we would go down and take any increase in profits clear down to the bottom. They had practically no profits in 1939 and this is the reason the percentage is so terrific.

Greenbaum: True, but it seems to me, Mr. Secretary, the example is rather an unfortunate one, because we are giving a case that shocks one, that that of all cases shouldn't be subject to an excess profits tax and then we end up by the new proposal only subjecting half its income to that, even as Blough says we ask for the other. I think we can do a little better on that.

H.M.Jr: I am sure you can.

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Blough: It may be that we should have a better example than that or state it in a way that wouldn't sound so shocking.

Magill: Certainly more sex appeal could be put in the last part of this memorandum. We were doing the last part of this memorandum at thirteen minutes of three.

Knollenberg: I want to go into the sex appeal of the first part of the memorandum when it comes time to. I will just be on record as wishing to have an opportunity.

H.M.Jr: Well, you can do it now.

Knollenberg: Well, you caught one of the things that struck me as being badly worded, but equally so was the use of the word a number of times, "unreasonable."

Now, if you are thinking in terms of a businessman, which my father was one of, there was nothing that he was prouder of than the fact that in his little business they did earn so high a percentage of profit on their invested capital, because he believed that that showed that he managed it good and was very capable at it. While if he were living now, he would be perfectly happy to pay a heavy tax as a patriotic duty, he would not in the process like to be condemned and that is what this seems to do.

Those are bad words. Those would be fighting words to him, and I think we ought to call them abnormal or get some word that isn't going to get people angry.

H.M.Jr: It is a good point.

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Kuhn: "Undue"?

Knollenberg: No, don't get the "un" stuff in it.

Magill: We say it first on page four. "In excess of a reasonable return on invested capital." What would you say? "In excess of a normal return on invested capital"?

Blough: Average.

Knollenberg: Average or normal were the two words I thought of.

Magill: I think "average" would be good.

Knollenberg: I think it would be even better than "normal."

Sullivan: What was the average last year? We used that, Roy.

Blough: It was around six, I believe.

Sullivan: For all business?

Blough: No, concerns making that income. Six or eight, it is in that range.

Kuhn: Would it also have made your father angry to have said that the success of a corporation is sometimes due to luck or chance?

Knollenberg: He would not have liked that. That was another - that is the sentence I am looking for now is that particular one. I thought it was unfortunate to have outlined it as though they were principal ways. They may be, but businessmen don't like to believe that.

Magill: Page four.

Kuhn: They all think it is due to their ability.

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- Blough: I agree with the unreasonable one. It has a long and honorable history in Public Utility regulation, and that is where it came from.
- Knollenberg: But it has a dishonorable history in tax law, because unreasonable accumulation of profits subjected to a fifty percent tax suggests something wicked.
- Blough: We will find another one. We don't want any fighting words in here.
- Sullivan: Whatever adjective you use, there is the subject of the entire fight. We tried all last summer to find some suitable adjective and we never did find it. That is where the nub whole fight centers, right on what is reasonable and what is normal, what is average.
- Blough: Well, the reason we didn't find it is because what they really objected to was not the way the word looked, but what the word meant.
- Sullivan: That is exactly it.
- Knollenberg: We have led up in those opening paragraphs to a situation where we say these are not normal times. You have to expect to pay extraordinary taxes. And the business man will shake his head affirmatively. And then you go on to say, but this is really a reasonable plan anyway, because you are bad boys, you are making more than you ought to.
- Magill: I think your "normal" and "average" are better words. Why don't you say, "Conditions of the times," or something like that, instead of luck or chance? I think luck or chance do play a part whether your father thought so or not.

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Knollenberg: I know, but why emphasize.

H.M.Jr: We have got a couple of sarcastic fellows in this corner.

Knollenberg: I know. I have known him before. (Laughter)

Blough: You really want the last half of page four out?

Knollenberg: Only this one sentence. "The existence of such profits while often due primarily to good management in very numerous instances is due to monopoly, imperfect competition, or luck and chance."

Blough: He doesn't even like "monopoly" in there.

Magill: That just happens to be true.

Blough: We can change "luck and chance" to something else, but do we want to rip the whole business out?

Magill: Change your "luck and chance" to "the conditions of the times."

Shoup: Isn't the basis of the idea that the profits are unnecessary?

Blough: That is really it.

Gaston: Unusual opportunity.

Kades: Extraordinary?

H.M.Jr: You word artists get together.

Gaston: Well, are we going to suggest now the possible alternative?

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- H.M.Jr: Now just before you do that, if you will excuse me a minute. I will be back in three minutes.
- Guy asks do we have to have an excess profits tax, and I take it he is going to suggest an alternative. Is that right?
- Knollenberg: Well, what do you think of "extraordinary"?
- Sullivan: We tried that, and that got the same results.
- Magill: I think your father would dislike that more, Knolley.
- Knollenberg: Possibly.
- Kades: Well, he would be proud to pay an extraordinary tax.
- Kuhn: In other words, extravagant.
- Magill: Well, I think you could use, "in excess of an ordinary return."
- (The Secretary left the conference temporarily and returned.)
- H.M.Jr: I would like to hear a minute - have you (Helvering) got an alternative suggestion, Guy?
- Helvering: Well, it is entirely alternative and it is an entirely different thing.
- H.M.Jr: All right, go ahead. I asked you last night for one.
- Helvering: I would like first, Mr. Secretary, to call your attention to the difficulties we have in administering an excess profits tax law.

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Now, I have had prepared a statement. I have three or four extra copies of it. Some of these contain eight specific objections in the administration of an excess profits tax law.

H.M.Jr: Excuse me. Shoup, are you in a hurry to get back today?

Shoup: No, I don't have to get back any particular time today.

H.M.Jr: Are you good until midnight?

Shoup: Oh yes.

Blough: He can stay tomorrow.

Shoup: Not all day, I am afraid, Roy.

H.M.Jr: This thing has to be jelled by midnight, anyway. Go ahead, Guy.

Helvering: Well, we have no advice, or course, or experience to guide us on the returns that have been filed, so we have got to take the situation as it confronts us and up to the present time or when this was computed, we had some forty thousand returns filed, of which five thousand seven hundred of them are taxable returns and thirty-seven thousand were not.

We have had requests for twenty-five thousand - almost twenty-six thousand extensions of time. This twenty-six thousand are all large corporations that say they have got to have time and so forth to find out what the situation is before they can make any report or any returns.

Now, we find our major difficulties are -

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I have outlined them here. Some of them are not as major as others, but in eight different sections, and if I might just read that, Mr. Secretary.

H.M. Jr: I wish you would, please.

Helvering: "Determination of base period income requires reaudit of years 1936 to 1939 inclusive. Determination of invested capital requires reaudit of all years from date of incorporation," if we are going to get it correct. Both are necessary where disclaimers have been filed.

I can't give you that figure because I would have to take each one and figure it out. That is, Mr. Secretary, where they do not choose to be on an invested capital basis or the other basis. They disclaim any choice of methods. Therefore, we have to audit both of them.

"In this connection, several hundred requests by larger corporations for permission to inspect records of the Bureau dating back occasionally over a period of twenty years have been received," already over there.

"No. 2: In cases of corporations filing excess profits tax returns on a consolidated basis, whose income tax returns for base period years were filed on a separate basis, the administrative difficulties described in (1) above will be multiplied and magnified to a great extent."

"No. 3: In all cases in which the invested capital base is used, computations to determine average daily invested capital under Sections 715 to 718 inclusive will be intricate and voluminous, and time-consuming," with all our agents and investigators and everybody else.

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"No. 4: No excess profits tax year may be settled until all controversy with reference to any prior base period year has been finally determined," and there are thousands of cases now pending in various states. That is, in the agents' offices being considered, Technical Staff Offices, Board of Tax Appeals and Courts.

"No. 5: Settlement of cases involving normal tax adjustments will be delayed due to the incidence of excess profits tax problems. This will handicap opportunity to collect normal income tax.

"No. 6: The thousands of taxpayers' applications for extension of time to file indicate that accounting offices of these companies charged with the duties of preparing the returns and to whom the records are fully available are encountering major difficulties in computing excess profits tax."

The same applies in another objection to our field staff and their.....

"No. 8: Multiplicity of types of returns based on income of different classifications - normal-tax income, excess profits tax income, declared value excess profits tax income, all retard the management of all routine procedural steps, as statements of original and additional assessments, and management of penalties, proposed and/or asserted."

Of course, the cost of that administration will be very materially increased. Those are a few of the things that we run into and try to administer in an excess profits tax law.

It occurred to me, Mr. Secretary, though it may be subject to very violent opposition,

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that a speedy collection of income taxes that we need, the satisfaction of the corporation themselves in paying the tax, the ease of administration, could all be readily passed on by a very drastic increase in a straight income tax on corporate income.

I can conservatively say that two hundred at least, and I think it is many more than that, men who have been in my office have complained about the uncertainty that they experienced in trying to arrive at a business procedure as a result of not knowing what the tax is going to be. They claim very - they object very bitterly to that situation.

So taking into consideration, Mr. Secretary, the ease of administration, the satisfaction of the corporation anticipating this tax, the speedy collection of the tax and everything like that, I think that a drastic increase in a straight tax on income of corporations should be at this time the thing to strive for, commencing with a - I am just giving this as just a thought - commencing with a tax on the first two thousand dollars of say thirty percent and graduating on up by three thousand, five thousand, ten thousand, until you reach forty percent with a saving clause in there to prevent corporations disintegrating, I mean forming smaller corporations, that is, where the same ownership split up. There had to be a saving provision in there for that purpose. And follow that with a surplus or undistributed profits tax after allowing the corporation thirty percent of their net income to do as they please with it.

A big corporation of a million dollars would pay four hundred thousand dollars with some small adjustment for the graduated scale.

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It would pay four hundred thousand dollars in tax, three hundred thousand of the original deduction for promotion purposes or whatever they wanted, and then a fifty percent tax on the undistributed part of any that is left. Say in this case three hundred thousand dollars.

H.M.Jr: That they withhold?

Helvering: Yes.

H.M.Jr: That they withhold.

Helvering: A law of that kind, I am quite sure, would be readily accepted by ninety percent of the corporations, because the most vigorous complaint they have is the uncertainty and the troublesome investigations and the money spent in keeping up there. One man who pays us about three hundred thousand dollars a year was in my office yesterday, and he said it cost them three percent of their total net income to keep track of the tax features of the law. The tax features of their business, rather.

So it seems to me that a law could be written here to get the amount of money we need with practically two short paragraphs.

H.M.Jr: Well, what is the matter with that as an alternative plan?

Magill: Well, I don't think there is anything. I would like to ask a question about it of this sort. I don't think the Commissioner emphasized as much as he might have perhaps, what would be true under this proposal. That is, the computation of invested capital itself is a terrific job.

Helvering: Oh, it is terrible.

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Magill: And if the tax is to hinge on invested capital alone, as this proposal does, as I said this morning, you are going to have to have quite a good group of people working on that and not much else. That is a big task and somebody has got to be given power just to bridge gaps that will exist.

You just can't find out some of the facts that will have to be known. Now, I would like to ask Mr. Blough and Mr. Shoup in particular whether they feel that the equities of imposing an excess profits tax, I mean equities aside from any public relations aspects of the case, in their opinion, will outweigh the clear administrative difficulties which the Commissioner has outlined, which undoubtedly exists.

A second point, which I don't think anyone needs to talk about, is the fact that an excess profits tax has a very clear popular appeal as an appropriate form of imposition and excessive profits ought to be taken by the Government. Everybody thinks that is the right idea.

Helvering: Of course, you raise these big fellows up to forty percent or forty-five percent if it is necessary. I don't think anybody would complain they are not paying taxes.

Magill: How about the other point? Would you two fellows feel that a tax on excess profits of the sort you have outlined in your proposal is - the virtues of it outweigh the disadvantage of Mr. Helvering's proposal of forty percent tax, say, on corporate profits, plus the administrative disadvantages of an excess profits tax.

Helvering: And the satisfaction of the taxpayer.

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Blough: After you, My dear Gaston, on that one.

Shoup: Well, let's get the issue pretty sharp if I am going to have to take a stand on that. I will be very glad to.

In the first place, I do think that in times like these we do need from the point of view of equity some kind of a tax which at the very least gets some of the undoubted windfall, unexpected, excess, unnecessary profits to come with this huge, unexpected, unforeseen defense program. We can all think of cases of that kind. I don't think the public morale would stand it, to get one thing, and to get them as such not just in a general sweeping way along with everything else. I mean, they have to be singled out.

Now, how far we should go in trying to get excess, how high the rate should be, how much revenue we should try to get, they are inclined to be somewhat slower than we have moved. In other words, I am not sure that we know enough yet about computation of invested capital and so forth to count on getting this billion or billion and a half, will it be, after the increase is allowed, from excess profits.

I would prefer to see a law which perhaps got somewhat less revenue but got it quite surely from those places where we, all of us, would agree in this room without a doubt is excess, and then be a little more lenient, perhaps, in cases where there mightn't be some excess or might be, depending upon how you look at it.

Of course, I find it difficult to weigh the equity against the administrative difficulties because I am not as familiar as I would like to be with the administrative difficulties.

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Commissioner Helvering knows, of course, so much more about that than I do that it is hard for me to put it on the scales, but I think it is worth a great effort, if you put it that way, a very great effort.

In the second place, I would like to say that --

H.M.Jr: Excuse me. A great effort to collect the excesses?

Shoup: Yes, sir. A great effort to compute invested capital and a great effort to compute the base period and all that.

H.M.Jr: You mean the effort is worth it?

Shoup: I think so, yes.

Then the second thing I would like to bring out is that in my mind --

H.M.Jr: May I stop you a minute? I just want to let you - for the past week I have been arguing along the lines as to principles, and I am more interested in the principles. I mean, just so that you know where I stand, I am more interested to see that the principles are carried out than I am the dollars.

Now, maybe that sounds silly. I think it is more important for unity in this country to make sure that we can satisfy the fellow on the street that we are getting the excess than it is that we get the dollars, so I just wanted you to know where I stand.

Shoup: I judge, then, that our views on that aspect parallel very closely, because I, too, am not interested in the absolute number of dollars so much as I am in being sure that we do get at least the most flagrant cases of excess.

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Flagrant is the word I use here. Of course, I hope you won't misinterpret it. I don't mean it with any bad intent, with all due respect to your (Knollenberg's) father. (Laughter)

In the second place, I don't think that from my point of view I would look upon the corporation normal tax as the alternative to the excess profits tax. If we need more revenue than we can get by the kind of an excess profits tax we can handle or if we find that it is too difficult to handle and need the revenue, I think we ought to turn elsewhere, because for various reasons I am very much concerned over the recent increases that have taken place in the corporation normal rate and I am very much concerned over future increases that might take place, especially if they are very large.

I should like to raise the point whether to get the billion four hundred million revenue that we would lose if we abandoned the excess profits tax, wouldn't we have to raise the normal corporate rate by more than just forty percent on the top?

Sullivan: Thirty-seven point eight.

Shoup: Only seven points?

Helvering: No, from the present twenty-four.

Shoup: But it is going to be thirty, isn't it, under the proposed bill and to make up the loss under the excess profits tax you would have to start from thirty and move on up.

Sullivan: I beg your pardon. It is thirty-eight point eight. It goes up fourteen and eight tenths percent.

Shoup: You only need eight percentage points on top

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to get a billion four hundred million.

Sullivan: That is right, because you see when you have both of them, Carl, whichever tax is imposed first cuts down the yield from the other.

Shoup: Quite true.

Sullivan: Those are the net figures I gave.

Shoup: Well, at any rate, without going into the figures, then, and it wasn't as high as I feared it might be, in any case I should urge that we not consider a broad blanket application of a normal tax, as an adequate substitute for an excess profits tax, that if we don't use an excess profits tax, we turn instead to something a little more refined and a little more taking into account of individual circumstances such as the individual income tax itself to make it worth even more.

But my chief concern over the normal tax is that I do think it is tending to increase the price level somewhat. I think that there is some evidence that corporations in general are going to set their selling prices somewhat in accord with --

H.M.Jr: Pass it along. They put it on the price of the article.

Shoup: It is a little harder to do with an excess profits tax, because it varies so much from competitor to competitor, and you can't make quite such an easy job of it, adding tax to price. And then, of course, I am also concerned over the tax of the small corporation. I think it has been getting very bad treatment in the past five or ten years, and the place

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where you just distinguish between them, you wonder whether you are going to have a partnership or a corporation. You take a look at the Federal tax laws and you shake your head and say, "No, I can't incorporate."

The businessman, not the wealthy man investing a little money but the moderate sized businessman who would like to have the corporate form but can't afford it under our laws.

Helvering: Could I just add a little there?

Shoup: Yes.

Helvering: In that connection now, suppose he was doing away with the corporate form and took an individual business, our surtax rates would be higher than the corporation rate if he made any amount of money at all.

Shoup: Well, I don't think it would have to be higher, would it, on the people that I am concerned with, the ones with five and ten thousand, three to five thousand income, and who have these little businesses that they would like to incorporate if they could? I know of several instances like that.

Sullivan: Could I point out some figures here that might be illuminating in this particular discussion?

There are about two hundred fifty thousand corporations paying a corporate income tax. There will be about thirty-one thousand pay an excess profits tax this year. Mr. O'Donnell estimated that under the original Treasury plan on '41 - on 1941 calendar year business, there would be about forty thousand corporations pay excess profits taxes.

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When we are discussing a general increase in the corporation income tax rate, we are talking about an increase that falls on two hundred fifty thousand corporations, and when we are talking about excess profits, we are talking about a tax which applies now to thirty-one thousand and which under the original Treasury proposal would apply to forty thousand corporations. I thought those figures might be helpful.

Helvering: Yet almost without exception every businessman that has talked with me, and I talk to some every week and nearly every day and sometimes two or three a day, they complain bitterly about the uncertainty of taxation, that is, what they can do as to dividends, what they can do as to extension of their business and so forth, which brought me to the conclusion that if a survey was made of what they would like, if you would say to the corporations generally, "We are going to have to raise so much money, would you like to have this on a straight tax or the combination of the two," and I will say to you that I would estimate that two percent of them would say, "The straight tax so we know what we are going to do."

H.M.Jr: Two percent?

Helvering: No, I mean two percent would say on the double system as against ninety-eight percent on the straight tax, because I haven't heard a single one yet choose the straight tax, and the excess profits tax as a preferable method against a higher straight tax, income tax.

H.M.Jr: Well, could I just say this, and John, you watch me very closely.

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In my talk outside with Sullivan, this makes it easier for the Treasury, he tells me that he is more than pleased to go before the Committee and represent the Treasury as to principles set down here.

Sullivan: That is right.

H.M.Jr: Is that right?

Sullivan: Yes, sir.

H.M.Jr: So that makes the job very much easier as far as we are both concerned. So then, it gets down to the thing we have had the least time on, our suggestions to the Committee as to alternatives.

Now, again I want to state that I have been more interested in the principles and as long as Sullivan and I see eye to eye on that, I am willing to be a little hazy or foggy when it comes to the possible alternatives and also Mr. Doughton was very explicit when he told me, "Now, you can make some alternatives but leave it to the Committee to work out the details;" so the Treasury doesn't have to go up with a definite, clean-cut suggestion and say, "Well now, this is the only way to do it," or "This is the Treasury plan," but I do think from what Sullivan always told me, that it would be easier for us, possibly, if we went up with more than just one plan.

Magill: Then why don't we suggest that other one we were talking about this morning?

H.M.Jr: What is that?

Magill: That was at the tag end of the Commissioner's suggestion. Too, that is the possibility of a stiff tax on corporations with credit

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for dividend distributions, the idea being to push the earnings out into the stockholders' hands.

H.M.Jr: Well now, let me ask you this, because fortunately I don't have any pet plan. Would that, Ros, in any way be contrary to the principles which are laid down in the first part of this statement so ably? Could they throw that back in your face and say, "If you believe in all this, how can you advocate this?"

Greenbaum: It seems perfectly consistent to me.

H.M.Jr: Do they? Shoup is shaking his head there.

Magill: Well, the difference - why he is shaking his head, I suppose, is this, that under this proposal here we say that the excessive profits as herein defined, which has two branches, shall be subject to special taxation.

That is what we talk about. Under this undistributed profits tax scheme, they wouldn't be subjected to special taxation. All corporate profits would be taxed alike but we would try to put them into the hands of the stockholders so they would be subject to surtaxes.

Sullivan: And what you mean, Ros, is that those extraordinary profits would be forced out and subjected to the increased individual surtaxes.

Magill: To a very high individual surtax, yes.

Shoup: But they would be subjected to no higher than ordinary surtax.

Greenbaum: I think they would be.

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- H.M.Jr: See if you can sell it to Shoup. You don't agree either?
- Blough: It is not the same thing. It has no connection with it. It is good but --
- Knollenberg: No inconsistency. I don't agree that it particularly - it reinforces the other, but it certainly is not inconsistent with the other.
- Magill: I don't think it is inconsistent. It is just a different plan.
- Shoup: Yes, I would agree to that. It is no substitute for the excess profits tax. Either we believe in the principle of the excess profits tax or we don't. I don't see that that has necessarily much to do with our decision about what to do with undistributed profits and so on.
- If we are for the principles of an excess profits tax, let's utilize it; and if not, let's not.
- H.M.Jr: Wait a minute, I am not getting this straight. We are talking about - we went through that whole first part which after a week puts down in clear technical language what I would like to see as the Treasury's standpoint. Then we say the way to do this thing is the way we did it last summer plus a ten percent tax on the fellow who earns less than four percent.
- Now, can we say, "Gentlemen of the Committee, if you don't like doing it that way, still believing in the principles, you can arrive at the same result through a high corporate tax combined with an undistributed profits tax"?
- What?

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- Knollenberg: No, you can't say you would arrive at the same result. The same things result.
- Helvering: Arrive at the same number of dollars, yes.
- Shoup: There are many ways to get the same number of dollars, including sales tax.
- Foley: There is a high road and this is the low road.
- H.M.Jr: Then you all agree with me that you can't accomplish the results through a corporation tax plus the undistributed profits tax, so don't we get back to the thing which John says he doesn't like but he says - he took a licking last summer and he is willing to do it again if necessary for the Treasury. Go up and say, "Well, gentlemen, we can't think of any other way."
- Sullivan: Well, I think there is a refinement of what Commissioner Helvering suggested that is consistent with these principles.
- H.M.Jr: Let's have it, John.
- Sullivan: And that is what we discussed earlier in the week here, raise your normal tax so that they will all be paying something and none of them will be escaping and then your excess profits tax on top of that.
- H.M.Jr: You mean that everybody would have to pay at least a forty percent tax?
- Sullivan: That is right.
- Gaston: Then you have all the administrative difficulties that Commissioner Helvering spoke about.

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Magill: I would like to make another point here, that I think isn't quite clear from what Shoup has said. Mr. Doughton used always to make this speech about having wished to have his taxes so adjusted that we only caught the goats and didn't catch any sheep. That was always his speech.

H.M.Jr: He likes to save his money, but he likes his WPA appropriation for North Carolina, too.

Magill: Well, that is another aspect of the thing. In this scheme you have here we say in substance what I daresay is true, that this scheme will catch, we hope, seventy-five goats and twenty-five sheep or something like that, but don't think for a minute that the people who are going to get taxed very heavily through this scheme are all American Car and Foundrys. That is the thing you look at. That is the goat, but there are also going to be some people that are paying like the dickens through this scheme whom if they were out in front of you here, you would say, "Well now, wait a minute, let's fix this so they won't get caught."

Now, the undistributed profits tax - I use that phrase, although I wouldn't call the tax which we have in mind that, but anyway, I think you all know what we are talking about - that also will catch a considerable number of goats and some sheep. Well, it is not exactly the same goats, not exactly the same sheep, and so you can't say that one is literally a substitute for the other.

On the other hand, the undistributed profits tax method too has great advantage and it does avoid Guy's administrative troubles,

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as far as that is concerned.

- Gaston: It is more consistent with the theories we apply to individual taxation. That is, it makes the corporate tax more consistent with the individual income tax structure, but it certainly is not applying the excess profits tax principle or anything corresponding to it.
- Shoup: That is all I meant. I didn't mean to say that this other thing wasn't a good idea. As you know, I think, I agree with you on that much, but I merely wanted to get across the idea that I did not think it was in principle the same idea as the excess profits tax.
- H.M.Jr: Well, Ros, in a few minutes, if you are still here, is there any other plan, an alternative plan - I mean, this plan that Sullivan is talking about, that you could say would arrive at the same - maintain your principles but arrive at the same result as if we took the present tax law and said we would put a floor in there at forty percent so if we don't catch them one way at least we will catch them another? Put a floor in.
- Magill: Of course, I am assuming part of John's idea. That is, I assume that what we are proposing here is going to be on top of an increased corporate rate.
- Now, I don't know whether you have settled on that or thirty percent or some other figure.
- H.M.Jr: Let's say thirty percent. Everybody talks thirty percent.
- Magill: You would have a floor under this particular proposal. I am very much impressed with

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Guy's administrative difficulties. Those are very real, and I asked the question I did with that in view, as to whether the game is worth the candle. That is, is there enough advantage out of this excess profits tax to justify the great hardship on his machine, which I think there will be.

Now, as I see it, there are two or three answers there which on the whole seem to me sufficient, although I think it is a close case.

First of all, I think this moral point is a very important one, that your public who is being asked to endure this and this and this, expects an excess profits tax. You can put it if you want to in that form, they have been oversold.

Secondly, that the excess profits tax will apply to comparatively few companies. There are forty thousand which is an awful lot, and they are the biggest ones in the country. They are going to be headaches for certainly five years to come, and probably ten, to the administration.

And then third, I still think that what we have said here is so, as far as your principles are concerned.

H.M.Jr:

But --

Magill:

I don't like the thing very well, either. What really gives me pause, why I really have a sneaking affection for this alternative scheme is that I don't think you are going to get this. I think you will probably get another one of these abortions like you got last year, and I certainly don't like the abortion as well as I would the alternative.

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Shoup: Agreed.

Gaston: You take in Guy's plan, what you have to say in your lead on your other plan is this, that if you believe in the excess profits tax principle, if you want an excess profits tax, the thing you have now is an abortion and we believe this is substantial proof, what we are recommending here.

Paragraph 2. If you don't believe in excess profits and don't want an excess profits tax, then here is a substitute which will produce about the same money and will be consistent with the principles that we applied to individual income taxation.

H.M.Jr: What is the matter with saying that? Without using the word "abortion"? (Laughter)

Gaston: I can think of better words.

Sullivan: While Ros is here, could I try out scheme three?

H.M.Jr: Sure.

Sullivan: Have you finished with this one?

H.M.Jr: Sure. You have got to do the talking.

Sullivan: Here is the proposal that started all the discussion, Ros, that now a corporation computes its corporate income tax and that is a deduction from - in computing its excess profits tax.

If we leave the rates alone, allow ten percent for new capital and shift the precedence of deductions, we will pick up enough so that we will - well, we will pick up six hundred sixty-two million dollars on excess profits.

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- Magill: I don't know if I get that shift.
- Greenbaum: What do you mean by "shift"?
- Sullivan: In computing the two taxes, the corporation first computes its excess profits tax and that is a deduction in computing its income tax and the way that operates is that the invested capital, the allowable rate drops from eight percent to five and a half percent and the average earnings drops from the present credit now of ninety-five percent to seventy-nine percent.
- Gaston: A 30 percent tax on it.
- Helvering: Just the shift in the credit, Ros, is all it is.
- Blough: The present normal tax, the thirty percent normal tax, would become part of excess profits net income instead of being out as it is under the present law.
- Greenbaum: What do you mean by "shift," you mean you don't allow it?
- Sullivan: No, the way it is now, when you figure your corporation taxes, you first compute the regular income tax. Then that is deducted in arriving at your excess profits tax net income.
- Under this shift they would first compute their excess profits tax and that is deducted in arriving at their corporate income tax net income.
- Magill: The thing doesn't seem right to me somehow or other.

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- Sullivan: That is the way it was done before, Ros.
- Magill: I daresay so, but you couldn't sell me.
- Sullivan: Ros, don't you remember - Carl, I think, does - we discussed for a couple of weeks down here which - the order in which we would have them last summer?
- Blough: Just going back to the 1918 law.
- Sullivan: That is right.
- Greenbaum: What is the idea of the shift? You get more money?
- Sullivan: You reduce allowable invested capital to five and a half percent.
- Magill: That is the point that bothers me. Is there any reason for doing this except to get the six hundred million?
- Greenbaum: That is what I mean.
- Sullivan: Well, the appeal it had to me, Ros, was that it appeared to be the only way in which we could reduce the ninety-five percent on average earnings companies.
- Magill: Well, I don't know. By the same token, I don't know whether I like it very well.
- Sullivan: There is going to be a fight up there to restore that ninety-five to a hundred.
- Greenbaum: Of course that wouldn't solve any of the Commissioner's administrative difficulties.
- Sullivan: None at all.
- Greenbaum: They would be exactly the same.

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H.M.Jr: Let me just see if we can find a time for a minute and then after Ros goes we will all relax.

Magill: I will stay and keep you at a tension if you like.

H.M.Jr: This is the way I would like to do it. I think this is a good way to put it up to the President.

We have got here a strong power for argument for the principles. Then we come along and say, "Now, gentlemen, the best way that we know to apply the principles is taking last summer's plan with this additional suggestion of ten percent on the companies -" I will say it again. What I am saying is this is the way I think so we don't get side-tracked.

I think the people here have given me a wonderful statement outlining the principles, which I think is what the President wants. It follows closely the memorandum of last summer, the July 8 memorandum. Then we come along and say, "Now, if you want to put these principles in the law, the best way we know is to do it the way we suggested last summer, with that certain refinement of putting the ten percent on the people who earn less than four percent.

"Now, that is what we think. We believe in these principles. The President believes in these principles. However, gentlemen, if you don't want to do this and you want something else and you don't believe in these principles which we do, here is an alternative suggestion which won't accomplish these principles but will raise the revenues, and that is a very simple method of a high corporate tax plus --"

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Magill: Credit for distribution.

H.M.Jr: Yes.

Now, the reason I am saying this in the room and strictly in the family is, we will go along this way and if the President comes along at the end and doesn't like the other, he can just say, "No, leave the last part off," you see. We set it up, the strong argument the way I think he thinks and I know I think, and then say, "Now, this is the way we like it. If you don't like this, here is another way to raise the money. It won't accomplish what we are talking about, but it will raise the money."

Then the President can simply say, "Henry, leave it out," but if he lets it go, O.K.

What is the matter with that, Eddie?

Greenbaum: That is good. I would like to know --

H.M.Jr: What is the matter with that?

Magill: O.K.

H.M.Jr: I mean, as an alternative thing. I wouldn't go in and try to plug for it, because that weakens the other. I will be a little intellectually dishonest and won't give all the good reasons that Guy Helvering has got for it.

In other words, I am not going to go out and sell the damn thing, but gentlemen if you just want to raise the cold dollars and don't care about the principles, here is the easiest way to do it.

Helvering: Well, you talked to me about the suggestion.

H.M.Jr: I know, and we will put it in. It will be at

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the end, and if the President doesn't like it, he can "X" it out. What is the matter with that, Ros?

Magill: That is all right.

H.M.Jr: We won't give a sales talk.

Magill: I think it would be a proper thing to do. I don't mean as a sales talk, but as I was saying this morning, I think it would be a proper thing to do to say in there somewhere, to work in in a sentence, that there are very serious administrative difficulties in connection with an excess profits tax.

H.M.Jr: I don't want to weaken it.

Greenbaum: Has any study --

Gaston: You could say in talking about this plan, it will be administratively somewhat more simple.

Magill: All right, put it that way.

Greenbaum: Mr. Secretary, has any study been given to the possibility of keeping to the principle of the excess profits tax and still eliminating some of the administrative difficulties? Obviously many of them will still remain, but I should think something could be done along those lines and an indication to that effect in the statement.

Helvering: Well, I wanted to submit a copy of that statement to the boys here so they would have it as well as ourselves when we are getting the - I didn't go into the most intricate and bad problem and that was the adjustment of abnormalities in order to - in the years in which they occur.

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For instance, a company may have in '39 a strike and in '36 a flood. They are going to claim abnormalities in those years which may affect this year as well and that is one of the most complicated things we have, that Section 721.

H.M. Jr: Shoup, what is the deadline that you have to be back?

Shoup: Well, I have an examination to attend tomorrow afternoon. I suppose that is the deadline. That is about three or four o'clock.

H.M. Jr: So I mean you could - if I want to come back at eight tomorrow morning --

Shoup: I can come back at eight tomorrow morning, just so I can get a plane back in the afternoon.

I was going to say that a lot of our difficulties on the present tax arise from our desire to be sure not to hurt anybody, to give everybody the needed cushion and be sure he has one and if we wanted to be a little hard hearted, which we could afford to do if we had a somewhat less rigorous rate scale, we could make it a good deal more simple.

Sullivan: Taking in more of them, you are going to have many many more pleas for relief in this session of Congress than we had in the last one, Carl. I think that is what Ros had in mind, with its ending up as an abortion because if they accept the principle, they will relief-amend it to death.

Shoup: I don't see how that follows necessarily, John. You raise a billion four hundred million out of the excess profits tax one way or the other. I would hesitate to guess ahead of

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time which method would cause a greater number of complaints of intensity. It would seem to me it would depend in either case on just how many of these provisions, cushions, et cetera, et cetera, you had scattered along to take care of the hard cases.

Sullivan: The ones using the average earnings are about two to one. If two thirds of them are going to be thrown over into the other basis --

Knollenberg: It very much enhances the administrative difficulty. I think the President ought to have that warning note struck in this memorandum. If we are trying to sell him this, we ought to give him the out on it, which that certainly is.

But there is that drawback. Otherwise, he is going to hear that later, and I should think he would feel very much aggrieved that he hadn't been warned of it.

Greenbaum: That is what I said to Ed.

Sullivan: Well, there isn't any doubt about that. That is where the holler is coming from, and that is what the holler is going to be about.

Knollenberg: Mr. Helvering for one could tell him of that very serious drawback in our proposal.

Helvering: I have been impressed a great deal and perhaps too much, by the continued complaint about the uncertainty, as they nearly all put it, of our program with our business. We will be able to do this, we will be able to do that.

Well, their experience is that their men have computed their tax and our boys come around

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and upset it and they don't know just where they are.

- Knollenberg: This will more than double the number of corporations that are now in that position of uncertainty.
- Sullivan: Two thirds of those who have filed so far have filed under average earnings.
- Helvering: Yes.
- Gaston: This will require us to figure invested capital on all corporations.
- Sullivan: Every one?
- Blough: The ascertainment of invested capital will be of almost nominal importance for all concerns between four and ten percent and of minor importance in determining the rate of tax to apply.
- Sullivan: Oh no, because every one of those concerns will have to figure its invested capital in each of the base period years, so that it can determine its rate of earning in the base period.
- Blough: To begin with, I think we can foreshorten that a little by allowing them average earnings in dollars of four percent of current invested capital or ten percent of current invested capital in dollars and thus foreshorten a lot of that calculation. I believe we could do that and cut out a great deal of the invested capital computation.
- Sullivan: We tried that last summer, didn't we?
- Blough: No.

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- Greenbaum: I meant something like that whereby you could stick to your excess profits, the principle of it, and still remove a lot of the administrative difficulties by short-cutting, even though there may be what you have been calling hardships or cases of that kind.
- Sullivan: Why don't you repeat your suggestion, Mr. Knollenberg, for the Secretary.
- Knollenberg: My suggestion was, Mr. Secretary, that in presenting this plan to the President in a favorable light, we ought in fairness to him and also to ourselves warn him that this plan will greatly increase the number of corporations which will have to compute their invested capital and hence will increase the Commissioner's difficulties of administration. Otherwise, he may be sold on this plan, because he doesn't appreciate its objection.
- H.M.Jr: Well, you want to keep me intellectually honest, I see. (Facetiously)
- Knollenberg: Well, not just because it is intellectually honest but because I also think it is expedient that we should give him the warning when giving him the pleasant aspects.
- H.M.Jr: I think you are perfectly right, and that would protect him.
- In other words, before he goes overboard on it, that should be pointed out.
- Sullivan: That is where the holler is coming from.
- H.M.Jr: That is all right, let's do that.
- Now, Shoup, do you think you could draft me a paragraph - seeing you have written

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a book on it - on the Treasury's part in this economic program as to what we are - we think the tax plus the savings bonds should attempt to do?

Shoup:

Mr. Secretary, I honestly couldn't draft a paragraph that would say very definitely what the Treasury ought to do, because if you don't mind my putting it in at this point, this study I am going to be on this summer and of which I believe you know something, Dr. Gulick perhaps spoke to you about it, is dealing with just that thing, and is going to take us a while to get something definite, but I certainly could put in a paragraph which I think would be perhaps what you want now, giving some general statement as to the aim and objective without committing the Treasury to any set figure or set portion that it would later want to reconsider.

H.M.Jr:

Could you do that?

Shoup:

Yes, sir, I could try it.

H.M.Jr:

Well now, what I would like to do, if Sullivan and Blough and the others can see what we have got in mind, let these fellows go to work, see, and if my host would let me come back here, say about ten o'clock tonight - Eddie, can I do that?

Greenbaum:

Sure.

H.M.Jr:

Would you come with me?

Greenbaum:

Yes.

H.M.Jr:

Or is that breaking up your time?

Greenbaum:

No, that is all right, let them go home.

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- Foley: Put the liquor away, Ed.
- H.M.Jr: Ten, ten-thirty?
- Greenbaum: Ten-thirty is all right. It would give them more time here, too.
- H.M.Jr: I could drop down here say around ten and take a look at it, and then if it is all right, we could take another crack at it at eight tomorrow morning. That is Mr. Foley's favorite hour.
- Gaston: They will have from ten-thirty to eight to put it into shape. (Laughter)
- Foley: Do what we did last night, Herbert.
- Greenbaum: Knollenberg and I will like that, because that lets us start work fifteen minutes later than usual.
- I have a few minor suggestions in regard to this draft. I wouldn't have to take it up here. I could take it up with Mr. Blough. It would maybe save time.
- H.M.Jr: I am beginning to run down.
- Well, now, let me ask, Blough, what I would like to say to you, with Mr. Sullivan's permission, only let those fellows come in to help you that you really want, and don't be polite about it, see what I mean? I mean, if you get too many people that want to offer to help you, just say, "Well, get the hell out of here," see?
- Blough: Thank you. It will be a great help.
- H.M.Jr: You have done a beautiful job, and I don't know who has been working with you, but in

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other words, let's leave it this way, if it is all right with you, John. You invite anybody in to help you that you want.

- Blough: The way I work best is to have these people talk to me and tell me - give me ideas and tell me how they think it ought to be, and then go off by myself and work alone.
- H.M.Jr: You did a beautiful job, didn't he this morning, John?
- Sullivan: Yes, he certainly did.
- H.M.Jr: So, you work the way you want and I will drop down here tonight around - oh, it will be about ten-thirty, you see. Is that all right?
- Blough: Sure.
- H.M.Jr: Can you take it physically?
- Blough: Yes, indeed. I am still pretty tough.
- Sullivan: Could I ask one question?
- Foley: He is young and strong.
- H.M.Jr: I think he is. Well, you can look forward whenever we get this and the President okays it, from then until Monday you can go to bed.
- Foley: To rewrite it.
- H.M.Jr: No, it will be finished.
- Sullivan: The question I was going to ask was this. Are we now going to have just two suggestions?
- H.M.Jr: Well, isn't that enough?

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- Sullivan: Well, I don't know. We could have three or four.
- H.M.Jr: We are going from what we take is the best to carry out the principles on the one hand to the simplest thing to get the money on the other.
- Gaston: I think it would be a great mistake to add any more to it. It would make a joke out of the thing.
- Foley: I think we have come a long ways since Monday night.
- H.M.Jr: Yes.
- Foley: And I would hate to see - show a state of confusion here, publicly, that could be picked up by the press and used as a criticism of the Treasury, and I think very well that might happen. If we have too many things that are just proposals, things that we have used in the past, discarded and thrown back at the Committee again.
- Gaston: What you are proposing now is clear-cut. You make a definite recommendation of one plan. You say, "If you don't believe in this principle, here are ways you can raise the revenue."
- H.M.Jr: Eddie?
- Greenbaum: I am in favor of only two, because I feel that the one thing is the basic principle favoring excess profits and the other thing is the legitimate alternative of pointing out the administrative difficulties in a simple method which would raise revenue without doing the other, and I think we will over-complicate it if we go beyond that.

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H.M.Jr: Shoup?

Shoup: I should prefer to have no more than the one alternative.

Knollenberg: Agreed.

Helvering: Oh yes, I think you will confuse it to get more in there.

H.M.Jr: There is your answer.

Sullivan: Then if the Committee inquires if we have made any study of improving the present law, our answer has to be yes; and we have rejected the results.

H.M.Jr: Now wait a minute.

Greenbaum: Why isn't this a way?

Foley: This is the way to improve the present law.

Sullivan: Oh well, I know, but this is going to something entirely different. This is going to an excess profits tax law in lieu of the present war profits tax.

Foley: That is what we wanted in the first place.

Sullivan: I understand that, Ed, but if they ask me if we have made any study of improving the present war profits tax act, our answer has to be yes, and we have rejected it.

H.M.Jr: In favor of this.

Foley: This is our proposal.

Gaston: Yes.

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- H.M.Jr: In favor of this.
- Foley: This is the only recommendation we have to make.
- H.M.Jr: And until we know how the Committee feels, we don't know in what direction they will go.
- Shoup: And this doesn't preclude us from making further suggestions for improvement.
- Blough: We would have to assure them, though, that we would help and have suggestions on any improvement in the present law.
- Sullivan: And we have none at the present time.
- H.M.Jr: Now, don't make it too difficult, John.
- Sullivan: No, but I don't want it to be too difficult for me Monday, sir.
- H.M.Jr: Well, you can say this, that we aren't prepared because for a very good reason, we expect thirty-seven thousand returns and we have only got five, is that right?
- Helvering: Seventy thousand.
- H.M.Jr: How many?
- Helvering: We will have seventy thousand returns.
- H.M.Jr: And of which how many have come in?
- Helvering: Well, I said those who will pay excess profits, report on the excess profits basis. Five thousand are in now that will pay a tax in all probability, and thirty-seven thousand are in that will have no liability according to their returns.

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Now, all the big ones, which leaves another twenty-eight thousand, of all the big ones, twenty-five thousand of those have asked for an extension of time.

H.M.Jr: I think that is your answer, John.

Sullivan: I don't want to prolong the discussion, but I am afraid it isn't; because if we are not prepared to pass on the present, we are in difficulty in the other, but I will --

H.M.Jr: Well, you think fast on your feet.

Sullivan: I will talk that out with you later.

H.M.Jr: You say you are not ready.

Blough: Could you say this, that as to suggestions for improving the present law, you will be glad to go into them in executive session of the Committee at any time they want you to or something like that?

Sullivan: Yes, if they are satisfied with that, that is the easiest way out.

H.M.Jr: Well, think it over.

Sullivan: Yes, sir.

H.M.Jr: Do you think we are all right, Mr. Knollenberg, on this?

Knollenberg: Yes, sir, I do.

H.M.Jr: Ferdie, how do you feel?

Kuhn: I think you are always under one handicap when you come up to recommend a change in some plan that you have presented only a

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few weeks before, and the best way to get over that is to show that you have principles and that you are sticking by them and that those mean something in the alterations which you are proposing and I think this is a swell statement, very orderly and clear and it needs a few more examples added to make it perfectly understandable and then it is good. I like it.

H.M. Jr: Well, the point is, the worst thing they can accuse us of is saying that the Treasury is a pig-headed organization and they thought that way last summer and they haven't changed.

Kuhn: But you are not pig-headed if you now go up and make a change, but the change has got to be in accordance with some principle that you hold.

H.M. Jr: Well, we are not changing. We think we were right last summer and we still think we are right; and as the returns begin to come in, the evidence is on our side.

Kuhn: May I ask one question? It may be the result of ignorance. In the alternative proposal of the straight corporate tax, would that be a graduated tax to take care of small businesses?

Sullivan: Yes.

Kuhn: It would be?

Sullivan: Yes.

Knollenberg: It could be based on income?

Sullivan: It is now.

Kuhn: I mean, it would continue to be?

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Helvering: The rate would be relatively higher, though, even for the smaller ones.

Sullivan: Are you coming down here tonight, Herb?

Gaston: At ten-thirty.

Sullivan: I will pick you up.

H.M.Jr: Ferdie, will you be back, or have you got something else?

Kuhn: If you would like me to be, if I can be of any help.

H.M.Jr: No, but you started with me and I would like to have you see me through this.

Kuhn: Sure.

H.M.Jr: Could you come back, Mr. Knollenberg, or is it asking too much?

Knollenberg: No, I will be delighted. Ten o'clock or ten-thirty?

H.M.Jr: Ten-thirty. I think we will call it a day now, as far as I am concerned.

Foley: Adjourn until half past ten?

H.M.Jr: Yes.

DRAFT OF EXCESS PROFITS TAX STATEMENT

Your Committee is now engaged in formulating changes in our tax system to accomplish two main objectives: (1) to provide the total revenues that we need to enable us to finance the great defense expenditures that we are committed to make; and (2) to assist in maintaining the economic health of the nation. Our people know that we are faced with a great challenge. They know that great sacrifices must be made and they are prepared to make them. They rely upon us so to plan our financial program that, however severe its burdens may have to be, they will rest fairly and justly upon all individuals and all businesses.

The tax program which you will propose will necessarily consist of many elements. Any one tax, viewed by itself, may appear to be stringent and oppressive. All must be viewed, however, as parts of a whole. These are war times. Taxes that would not be proposed in peace times are a necessity now. We cannot give effect to all those niceties of exemptions and saving clauses that are appropriate to easier occasions but today will defeat our ends.

I have been asked particularly to discuss the excess profits tax, first enacted in the fall of 1940. Our experience with it is still limited, for many of the returns of the largest corporations have not yet been filed. Enough have been filed, however, to convince Treasury officials in charge of administration that important changes in the law must be made in the interests of fairness.

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We are collecting large sums by means of this tax, but the profits of a good many other business firms are going entirely untaxed, although these profits appear excessive by any standards I know how to apply. Here is certainly a place to broaden the base. Surely the skill of this Committee and its experts is adequate to the task of bringing within the tax the known cases of excessive business profits.

I want first to outline the principles which I believe should govern the taxation of excess profits; second, to indicate respects in which the present law fails to accord with those principles; and third, to suggest various possible remedies which the Congress may wish to consider.

I - Principles

Under present conditions some kinds of profits may be appropriately subjected to heavier taxation than other kinds to get a fair distribution of the burden and to avoid unfavorable effects on the defense program or on business in general that would result if the revenue had to be raised in other ways.

1. Defense profits

The first type of profits which should, in a period of this kind, be subjected to special taxation comprises the profits which may be reasonably attributed to the defense program. Such profits are being made out of the sacrifices of the people as a whole and should be returned to the people in taxes, insofar as may be possible without destroying necessary incentives to produce defense goods.

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In a majority of cases it is not possible to distinguish with perfect precision the additional profits demonstrably due to the defense program. The effects of defense spending are diffused throughout the whole economic system. It is necessary, accordingly, to determine profits due to defense by assuming that in general, increases in profits during the defense period are due to defense. Some relief can and should be granted where it is clear that this is not the case. Inability to distinguish just what are defense profits should not discourage us from subjecting them to special taxation even at the risk of hitting some non-defense profits.

2. Profits in excess of a return on invested capital

The other kind of profits that can properly be subjected to special taxation are profits in excess of a reasonable return on invested capital, even if this return was being earned in the years prior to the defense program. The existence of such profits, while often due primarily to good management, are in very numerous cases due to monopoly, imperfect competition, or luck and chance, and not to any outstanding service to the public. These excessive profits represent in large part money taken from consumers in excess of the amount necessary to produce the goods or services. When the imperfections of our economic machine have permitted this to happen, it is equitable and desirable that the excess profits

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be subjected to special taxation. Furthermore, at a time when heavy taxes must be imposed they should be levied where they will have the least harmful effects. To take an especially large share of the profits in excess of a reasonable return on invested capital will not cause any companies to go into bankruptcy or withdraw from business.

I am aware that excessive profits and for that matter the expected defense profits may have been so anticipated by the financial community that security prices may have become adjusted to them to some degree. The imposition of these special taxes may hit some owners of corporate securities harder than others. We cannot entirely disregard such vested interests, but we must remember that no legislation is passed and no progressive step is taken which does not disturb the established interests of some people. We submit that vested interests in high profits are entitled to no more protection than an individual's interests in a large salary, now subject to a heavy tax. These are times of war and changes must be expected.

I am also aware that the application of the principle of taxing profits in excess of a reasonable return on capital involves difficulties of both theory and technique. I feel sure that we should not allow these difficulties to stand in the way of our seeking to attain the main objective, mainly the special taxation of profits which should be subjected to such taxation.

II - Defects of the present law

In the light of the principles just stated, I wish to examine the excess profits tax law passed last summer, to see in what respects, if any, it fails to correspond to those principles.

1. Failure to reach large parts of defense profits

The Excess Profits Tax Act of 1940 was a clear expression of Congressional intent that profits growing out of the defense effort should be subject to excess profits tax. The law, however, has not achieved that objective. Many corporations that are the principal beneficiaries of the defense effort and that hold large government contracts are paying little or no excess profits tax. Some of these corporations are not only making more profits than they do in normal times but are finding it necessary to expand in order to fill defense contracts.

In the absence of complete excess profits tax returns an examination has been made of published financial data for certain corporations. One company which through March 31, 1941, had received over 70 million dollars of defense contracts and whose profits in 1940 were more than 3,000 percent larger than 1939 is subject to no excess profits tax whatever on 1940 earnings. The financial data of a large steel company which has received over \$250,000,000 of defense contracts indicate that its earnings in 1940 will be nearly 200 percent larger than in 1939 and that it will not be subject to excess profits tax. It is reported in one of the

financial periodicals that only 5 out of 12 large integrated steel companies will be subject to excess profits tax on the income of 1940, although it will be borne in mind that the steel companies have in general received huge amounts of defense orders.

These companies escape excess profits tax in whole or in part because of the allowance of a minimum credit of 8 percent of invested capital. This provision was inserted by the Congress not to protect these corporations, but to aid corporations that needed the safeguard of a minimum untaxed return on invested capital. The law did not distinguish among kinds of corporations and as a result neither taxed the defense profits nor adequately protected the corporations needing assistance.

2. Excess profits other than defense profits not taxed

Another serious shortcoming of the 1940 excess profits tax law is that profits in excess of a reasonable return on invested capital are not subjected to the tax unless such profits also represent an increase over the profits of the base period. For example, one company which earned during the base period an average of approximately 40 percent on its present invested capital will be free from the excess profits tax on income in any year equal to approximately this 40 percent and will be taxable only on such increases in income as it may enjoy. The failure of the law to reach a large portion of excess profits was due to the provision of a credit for every corporation equal to 95 percent of its base period earnings, regardless of the size of those earnings in relation to its invested capital.

III - Remedies

Revisions of the excess profits tax to be considered adequate, must eliminate the two gaps which I have pointed out are present in the existing law. The exemption of defense profits made by firms that have had large dormant invested capital can be stopped by reducing the 8 percent credit of tax-free earnings on invested capital. The gap resulting from allowing an unlimited average earnings credit can be reduced by requiring all corporations earning more than a stated percentage on their invested capital to pay an excess profits tax, regardless of their average earnings. It will be recalled that these were the basic elements of the Treasury excess profits tax proposals of 1940.

In that proposal corporations were to be allowed tax free their earnings during the base period, but with a minimum and a maximum. The minimum was 4 percent of invested capital with 6 percent allowed on the first \$500,000. The maximum was 10 percent. Thus, under the Treasury plan a concern which earned 5 percent during the base period would be allowed to continue to earn 5 percent free of tax. The concern which earned only 2 percent during the base period would be permitted to earn 4 percent free of tax. The concern which earned 15 percent during the base period would be allowed to earn 10 percent free of tax. This combination of a tax on defense profits and a tax on excess profits was calculated to reach a large proportion of both kinds with a minimum of hardship.

Under the Treasury proposal it was recognized that if businesses were to be expanded and investors were to put new money into corporations, an opportunity must be allowed to earn a substantial rate of return on new capital. The plan allowed an 8 percent return, regardless of the earning experience during the base period on old capital. If the Treasury plan had been applied in the examples previously presented, the tax results would have been quite different. The corporation which had a very high rate of return on its invested capital in the base period would have paid excess profits tax on half of its income instead of on about one-seventh under the present law. One of the examples of a corporation which had poor earnings during the base period would have paid excess profits tax on over one-third of its income and the other on about one-fifth of its income instead of both being entirely exempt.

Even with these tax increases, however, the Treasury plan would have failed to apply special taxation to substantial amounts of defense profits received by the corporations with poor earnings during the base period. To meet this defect we would suggest revising the 1940 proposal to provide that where the average earnings of the base period were less than the minimum of 4 percent, the excess profits tax should be applied at a lower rate, possibly 10 percent, to the current profits in excess of the base period earnings but not in excess of 4 percent on invested capital. This special rate of tax would subject all increases in profits during the defense period

to some special taxation while at the same time the rate would not be high enough to cause undue hardship to concerns whose increase in earnings over the low rate received during the base period did not reflect defense profits.

We would suggest also that the rate allowed on new capital be the same as the maximum rate allowed on outstanding capital, namely, 10 percent. It should be recognized that any maximum return on capital must be a somewhat arbitrary figure because businesses differ widely with respect to the degree of risk they face. Accordingly, it is desirable not to set too low a maximum rate.

Furthermore, it would be desirable to change the type of rate graduation from that existing in the present law, so that a relatively low rate of tax will be applied to the slightly excessive profits and the higher rates applied to profits that are more clearly excessive.

RB
5/15/41

May 15, 1941

Foley
Gaston

Kraft I
237

My purpose today is to discuss with you the Treasury's proposal for corporate taxation in the present crisis.

It is essential to bear in mind that we are in the midst of a very serious emergency. We are undertaking to exert a maximum of effort for national defense. We face the urgent need of great additional revenue to finance that effort.

The Treasury is called upon to meet expenditures greater than have ever been made in the nation's peacetime history, and probably greater than at any time in our history, in peace or war. At such a time we can not expect to rely on normal sources of revenue or be content with revenue in normal amounts. We must adopt extraordinary measures to deal with our extraordinary situation.

In searching for additional sources of revenue, we have sought to arrange our tax schedules so that corporations, like individuals, will bear their share of the tax burden in proportion to their ability to pay, regardless of their source of earnings.

It is not enough to prevent the relatively small number of corporations largely engaged on defense orders from

- 2 -

profiteering. Many leading and long established corporations realized very high rates of profit even when the business index was comparatively low.

Having in mind that it is the Treasury's responsibility to make suggestions and to analyze specific proposals for changes in the tax structure and that it is the Committee's responsibility to write the tax bill, I want to outline in general how we think the corporate tax yield can and should be increased.

When I appeared before a subcommittee of this Committee last summer, I recommended the enactment of an excess-profits tax law which would apply to all profits in excess of the rate of return on invested capital which corporations actually realized in the period before the defense program, subject to two qualifications. First, such a law would have allowed a corporation an exemption of not less than 4 percent on invested capital. Second, such a law would have subjected a corporation to a tax on those profits which it made in excess of 10 percent on invested capital.

For example, if a corporation made an average of 5 percent on invested capital in the period prior to the defense program, its profits above 5 percent would be subject to excess profits

- 3 -

taxation. But if it made an average of but 2 percent during the period prior to the defense program, only those profits in excess of 4 percent would be subject to the tax. And if it made an average of 15 percent in the period prior to the defense program, then the tax would apply to all profits in excess of 10 percent.

The Congress adopted a different proposal which the Treasury believed would discriminate against small and growing corporations. Because of the urgent necessity for prompt action; however, the Treasury did not press its objection.

The Treasury has never hesitated, however, to come before your Committee and ask it to remedy a defect or to eliminate an inequity whenever experience in the administration of the tax laws has revealed any defect or any inequity. Since, therefore, the method of excess profits taxation which was enacted into law last summer has proved, in our opinion, unfair and ineffective, I am not hesitating to come before you now to ask you to reconsider the Treasury's plan of last summer.

Many of the inequities of the law passed last year were remedied in the Excess Profits Tax amendments of 1941. The

- 4 -

present law undertakes to tax corporation profits which result from the defense program. We renew our suggestion of a plan which would tax all excessive profits made during the defense program.

The weakness of our existing excess profits tax law is that it erects a barbed-wire fence protecting these profits of well-established corporations which are not

May 15, 1941

Gaston Kroft II
281

My purpose today is to discuss with you the problem of corporate taxation in the present emergency. What I shall have to say is supplementary to the statement made by Secretary Morgenthau when the current hearings were opened and to the suggestions later laid before you on behalf of the Treasury Department.

Before attempting to review the present provisions of law with respect to corporation taxes and before offering suggestions in this field, I want to say something about the situation which confronts us and makes urgently necessary the work your committee is undertaking.

I don't think we can make any proper approach to our problem without bearing constantly in mind the fact that we are in the midst of a very serious national emergency. We are undertaking as a whole people to exert a maximum of effort for the national defense. We face the urgent need of great additional revenue to finance that effort.

The Treasury is called upon to meet expenditures greater than have ever been made in the nation's peacetime history, and probably greater than at any

- 2 -

time in our history, in peace or war. At such a time we can not expect to rely on normal sources of revenue or be content with revenue in normal amounts. We must adopt extraordinary measures to deal with our extraordinary situation.

We can not expect to devise a painless tax bill, nor one that is free of all inequities. That is not possible at any time, and it is certainly not possible in the light of our present need. All that we can hope to do is to minimize inequities and to distribute the burden as fairly as we humanly can.

The situation calls for sacrifices. As Secretary Morgenthau has already told you, we have had unmistakable evidence that the people are willing to make sacrifices according to their ability. As we call upon them to make those sacrifices we should again, as far as humanly possible, measure the sacrifices we call upon them to make according to their ability to make them. It seems to me permissible to remind ourselves that outside the tax field greater sacrifices are being asked and must be asked. There is no basis of comparison of the sacrifice of those

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who are asked to exchange the comforts of a job and a home for a soldier's pay and a soldier's hardships with the sacrifice of those who are asked to pay even drastically higher rates of tax.

To obtain the revenue we must have for sufficient support of our defense effort we need to increase substantially the yield of our corporate taxes. We have already suggested and the committee is considering heavy increases in taxes upon individuals. On the basis of ability to pay we can fairly call upon corporate earnings to bear a larger share of the load.

It is in the light of these considerations and, bearing in mind that it is the Treasury's responsibility to make suggestions and to analyze the effects of tax laws and proposals for changes in the law, while it is the committee's responsibility to prepare tax bills, that I now wish to offer some comment on the existing law and suggestions as to how additional revenue may be obtained.

Guy Helvering

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*May 15, 1940
4:15 P.M.*

Administering the Excess Profits Tax.

There is no advice to be had from experience in the management of any cases under the 1940 Excess Profits Tax Act, since but 5,758 taxable returns and 37,664 nontaxable returns of an anticipated total of approximately 70,000 due to be filed have been received. No excess profits returns have been as yet forwarded to field stations. There have been 25,988 requests for extension of time to file, representing the most important, difficult and complicated returns.

Major Difficulties Anticipated.

(1) Determination of base period income requires reaudit of years 1936 to 1939 inclusive. Determination of invested capital requires reaudit of all years from date of incorporation. Both necessary in every case where disclaimer is not signed. One or the other necessary where disclaimer of one basis signed. (In this connection several hundred requests by larger corporations for permission to inspect records of Bureau dating back occasionally over a period of twenty years have been received.)

(2) In cases of corporations filing excess profits tax returns on a consolidated basis, whose income tax returns for base period years were filed on a separate basis, the administrative difficulties described in (1) above will be magnified.

(3) In all cases in which the invested capital base is used, computations to determine average daily invested capital under Sections 715 to 718 inclusive will be intricate and voluminous, and time-consuming out of all proportion to possible benefits.

(4) No excess profits tax year may be settled until all controversy with reference to any prior base period year has been finally determined and thousands of cases are pending in various stages in offices of agents in charge, Technical Staff offices, the Board of Tax Appeals and the Courts.

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(5) Settlement of cases involving normal-tax adjustments will be delayed due to the incidence of excess profits tax problems. This will handicap opportunity to collect normal income tax.

(6) The thousands of taxpayers' applications for extension of time to file indicate that accounting officers charged with the duty of preparing returns and to whom records are fully available are encountering major difficulties in computing excess profits taxes.

(7) Field officers under less complex tax structures are operating with considerable difficulties to adequately protect the revenues. Expensive and lengthy courses of instruction appear essential to management of excess profits audit.

(8) Multiplicity of types of returns based on income of different classifications - normal-tax income, excess profits tax income, delared value excess profits tax income, retard the management of all routine procedural steps, as statements of original and additional assessments, claims for refund, scheduling of overassessments, and management of penalties, proposed and/or asserted. The costs of all administrative detail in collectors' offices, agents' offices, and in Washington will be exaggerated and multiplied.

May 15, 1941
Roy Blough
3:00 P.M.

DRAFT OF EXCESS PROFITS TAX STATEMENT

Your Committee is now engaged in formulating changes in our tax system to accomplish two main objectives: (1) to provide the total revenues that we need to enable us to finance the great defense expenditures that we are committed to make; and (2) to assist in maintaining the economic health of the nation. Our people know that we are faced with a great challenge. They know that great sacrifices must be made and they are prepared to make them. They rely upon us so to plan our financial program that, however severe its burdens may have to be, they will rest fairly and justly upon all individuals and all businesses.

The tax program which you will propose will necessarily consist of many elements. Any one tax, viewed by itself, may appear to be stringent and oppressive. All must be viewed, however, as parts of a whole. These are war times. Taxes that would not be proposed in peace times are a necessity now. We cannot give effect to all those niceties of exemptions and saving clauses that are appropriate to easier occasions but today will defeat our ends.

- 2 -

I have been asked particularly to discuss the excess profits tax, first enacted in the fall of 1940. Our experience with it is still limited, for many of the returns of the largest corporations have not yet been filed. Enough have been filed, however, to convince Treasury officials in charge of administration that important changes in the law must be made in the interests of fairness. We are collecting large sums by means of this tax, but the profits of a good many other business firms are going entirely untaxed, although those profits appear excessive by any standards I know how to apply. Here is certainly a place to broaden the base. Surely the skill of this Committee and its experts is adequate to the task of bringing within the tax the known cases of excessive business profits.

I want first to outline the principles which I believe should govern the taxation of excess profits; second, to indicate respects in which the present law fails to accord with those principles; and third, to suggest various possible remedies which the Congress may wish to consider.

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I - Principles

Under present conditions some kinds of profits may be appropriately subjected to heavier taxation than other kinds to get a fair distribution of the burden and to avoid unfavorable effects on the defense program or on business in general that would result if the revenue had to be raised in other ways.

1. Defense profits

The first type of profits which should, in a period of this kind, be subjected to special taxation comprises the profits which may be reasonably attributed to the defense program. Such profits are being made out of the sacrifices of the people as a whole and should be returned to the people in taxes, insofar as may be possible without destroying necessary incentives to produce defense goods.

In a majority of cases it is not possible to distinguish with perfect precision the additional profits demonstrably due to the defense program. The effects of defense spending are diffused throughout the whole economic system. It is necessary, accordingly, to determine profits due to defense by assuming that in general, increases in profits during the defense period

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are due to defense. Some relief can and should be granted where it is clear that this is not the case. Inability to distinguish just what are defense profits should not discourage us from subjecting them to special taxation even at the risk of hitting some non-defense profits.

2. Profits in excess of a return on invested capital

The other kind of profits that can properly be subjected to special taxation are profits in excess of a reasonable return on invested capital, even if this return was being earned in the years prior to the defense program. The existence of such profits, while often due primarily to good management, are in very numerous cases due to monopoly, imperfect competition, or luck and chance, and not to any outstanding service to the public. These excessive profits represent in large part money taken from consumers in excess of the amount necessary to produce the goods or services. When the imperfections of our economic machine have permitted this to happen, it is equitable and desirable that the excess profits be subjected to special taxation. Furthermore, at a time when heavy taxes must be imposed they should be levied where they will have the least harmful

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effects. To take an especially large share of the profits in excess of a reasonable return on invested capital will not cause any companies to go into bankruptcy or withdraw from business.

I am aware that excessive profits and for that matter the expected defense profits may have been so anticipated by the financial community that security prices may have become adjusted to them to some degree. The imposition of these special taxes may hit some owners of corporate securities harder than others. We cannot entirely disregard such vested interests, but we must remember that no legislation is passed and no progressive step is taken which does not disturb the established interests of some people. We submit that vested interests in high profits are entitled to no more protection than an individual's interests in a large salary, now subject to a heavy tax. These are times of war and changes must be expected.

I am also aware that the application of the principle of taxing profits in excess of a reasonable return on capital involves difficulties of both theory and technique. I feel sure that we should not allow these difficulties to stand in the way of our seeking to attain the main objective, mainly the special taxation of profits which should be subjected to such taxation.

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II - Defects of the present law

In the light of the principles just stated, I wish to examine the excess profits tax law passed last summer, to see in what respects, if any, it fails to correspond to those principles.

1. Failure to reach large parts of defense profits

The Excess Profits Tax Act of 1940 was a clear expression of Congressional intent that profits growing out of the defense effort should be subject to excess profits tax. The law, however, has not achieved that objective. Many corporations that are the principal beneficiaries of the defense effort and that hold large government contracts are paying little or no excess profits tax. Some of these corporations are not only making more profits than they do in normal times but are finding it necessary to expand in order to fill defense contracts.

In the absence of complete excess profits tax returns an examination has been made of published financial data for certain corporations. One company which through March 31, 1941, had received over 70 million dollars of defense contracts and whose profits in 1940 were more than 3,000 percent larger than 1939 is subject to no excess profits tax whatever on 1940 earnings. The

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financial data of a large steel company which has received over \$250,000,000 of defense contracts indicate that its earnings in 1940 will be nearly 200 percent larger than in 1939 and that it will not be subject to excess profits tax. It is reported in one of the financial periodicals that only 5 out of 12 large integrated steel companies will be subject to excess profits tax on the income of 1940, although it will be borne in mind that the steel companies have in general received huge amounts of defense orders.

These companies escape excess profits tax in whole or in part because of the allowance of a minimum credit of 8 percent of invested capital. This provision was inserted by the Congress not to protect these corporations, but to aid corporations that needed the safeguard of a minimum untaxed return on invested capital. The law did not distinguish among kinds of corporations and as a result neither taxed the defense profits nor adequately protected the corporations needing assistance.

2. Excess profits other than defense profits not taxed

Another serious shortcoming of the 1940 excess profits tax law is that profits in excess of a reasonable return on invested capital are not subjected to the tax unless such profits also represent an increase over the profits

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of the base period. For example, one company which earned during the base period an average of approximately 40 percent on its present invested capital will be free from the excess profits tax on income in any year equal to approximately this 40 percent and will be taxable only on such increases in income as it may enjoy. The failure of the law to reach a large portion of excess profits was due to the provision of a credit for every corporation equal to 95 percent of its base period earnings, regardless of the size of those earnings in relation to its invested capital.

III - Remedies

Revisions of the excess profits tax to be considered adequate, must eliminate the two gaps which I have pointed out are present in the existing law. The exemption of defense profits made by firms that have had large dormant invested capital can be stopped by reducing the 8 percent credit of tax-free earnings on invested capital. The gap resulting from allowing an unlimited average earnings credit can be reduced by requiring all corporations earning more than a stated percentage on their invested capital to pay an excess profits tax, regardless of their average

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earnings. It will be recalled that these were the basic elements of the Treasury excess profits tax proposals of 1940, *and it is this plan, with modifications dictated by experience, that we suggest.*

In that proposal corporations were to be allowed tax free their earnings during the base period, but with a minimum and a maximum. The minimum was 4 percent of invested capital with 6 percent allowed on the first \$500,000. The maximum was 10 percent. Thus, under the Treasury plan a concern which earned 5 percent during the base period would be allowed to continue to earn 5 percent free of tax. The concern which earned only 2 percent during the base period would be permitted to earn 4 percent free of tax. The concern which earned 15 percent during the base period would be allowed to earn 10 percent free of tax. This combination of a tax on defense profits and a tax on excess profits was calculated to reach a large proportion of both kinds with a minimum of hardship.

Under the Treasury proposal it was recognized that if businesses were to be expanded and investors were to put new money into corporations, an opportunity must be allowed to earn a substantial rate of return on new capital. The plan allowed an 8 percent return,

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regardless of the earning experience during the base period on old capital. If the Treasury plan had been applied in the examples previously presented, the tax results would have been quite different. The corporation which had a very high rate of return on its invested capital in the base period would have paid excess profits tax on half of its income instead of on about one-seventh under the present law. One of the examples of a corporation which had poor earnings during the base period would have paid excess profits tax on over one-third of its income and the other on about one-fifth of its income instead of both being entirely exempt.

Even with these tax increases, however, the Treasury plan would have failed to apply special taxation to substantial amounts of defense profits received by the corporations with poor earnings during the base period. To meet this defect we would suggest revising the 1940 proposal to provide that where the average earnings of the base period were less than the minimum of 4 percent, the excess profits tax should be applied at a lower rate, possibly 10 percent, to the current profits in excess of the base period earnings but not in excess of 4 percent on invested capital. This special rate of tax would subject all increases in profits during the defense period to some

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special taxation while at the same time the rate would not be high enough to cause undue hardship to concerns whose increase in earnings over the low rate received during the base period did not reflect defense profits.

We would suggest also that the rate allowed on new capital be the same as the maximum rate allowed on outstanding capital, namely, 10 percent. It should be recognized that any maximum return on capital must be a somewhat arbitrary figure because businesses differ widely with respect to the degree of risk they face. Accordingly, it is desirable not to set too low a maximum rate.

Furthermore, it would be desirable to change the type of rate graduation from that existing in the present law, so that a relatively low rate of tax will be applied to the slightly excessive profits and the higher rates applied to profits that are more clearly excessive.

TOP

May 15, 1941

File

Mr. Cochran

At 2:30 yesterday afternoon I telephoned Sir Edward Peacock in New York. I told him that Mr. John Russell of Honolulu had discussed with us a proposal for handling certain British direct investments in Hawaii and he told us he hoped such a plan could be consummated with Sir Edward's organization. Sir Edward confirmed that he had been negotiating with Mr. Russell and desired to know how we felt about the proposal. I told Sir Edward that the matter had been studied by us and that we offered no objection thereto but took the precaution of checking with Sir Edward before giving this message to Mr. Russell. Sir Edward appreciated our calling him. Incidentally, he said he had not consummated any more transactions since seeing us last but was making some headway and hoped to telephone sometime next week to come down and give an account of his plans and operations to the Secretary.

At 2:35 p.m. I called Mr. Russell's office in New York and spoke with his secretary, in his temporary absence. I told her to tell him that the Treasury had no objection to the proposal which he had submitted.

It should be recalled that Mr. Foley had drawn up a memorandum under date of May 12 analysing the proposal, which he and I had initialed, and to which Mr. Foley had obtained the Secretary's OK, as indicated on the original copy of Mr. Foley's memorandum.



HMG:lap-5/15/41

TREASURY DEPARTMENT

INTER-OFFICE COMMUNICATION

DATE May 15, 1941

TO Secretary Morgenthau

FROM Mr. Cochran

At 11:30 this morning I telephoned Sir Frederick Phillips. I let him know that I had just been called into the Secretary's office where our Public Relations Officer had recounted to the Secretary that at least three reports had been brought in by press correspondents of Mr. Seatree making the statement that "the Secretary of the Treasury was talking through his hat" insofar as the question of British ownership of Lever Brothers in the United States is involved.

I told Phillips that we had had one rumor of such remarks some weeks ago but had paid no attention to it. With this recurrence, however, we thought he should know of it. He confirmed my understanding that Mr. Seatree is an assistant with Sir Edward Peacock and Mr. Gifford, and was formerly an accountant in Paris. Phillips referred to the information which he has given us to the effect that the British do not include Lever Brothers in the United States among their direct investments here. I told him that we were aware of this. On the other hand, it had been our impression when testimony was being given before Congress on the Lend-Lease Bill that Lever Brothers were to be included, and the Secretary had so stated. There is thus some misunderstanding, but it certainly called for no expression on the part of Mr. Seatree such as above quoted. Phillips said that he would pass on an appropriate word to Sir Edward Peacock at once.



May 15, 1941

Under Secretary Bell

Mr. Cochran

Mr. Opie, who is substituting for Mr. Pinsoot as Financial Counselor of the British Embassy, telephoned me at 11:45 this forenoon. He stated that he had received two days ago, but had just gotten around to reading it today, a letter from London, dated April 22, 1941, instructing him to take up with the American Treasury the question of currency arrangements for the bases which we have acquired from the British. He said this dealt with basic principles.

I told Opie that he was just about two days too late with this letter, since bankers from Bermuda and contractors from New York who are operating in Bermuda had been meeting with the Treasury the past two days on this very subject. Opie said he had become aware of this since bankers, Messrs. Butterfield and Tucker, had called upon him. In this connection he said that the letter which he has received is based upon the idea that payments in the bases would be with American currency. I told him, and he had already heard, that the conversations of the past two days had been along opposite lines. That is, local currency should be used in payments in Bermuda, and the man provided with dollar checks for any allotments or remittances to the United States. Opie thought personally that this latter arrangement should be preferable from the British standpoint. He hoped, however, to discuss this question with us as soon as possible, since the Bermudians were staying over to talk with him after he had had opportunity to talk with us.

I immediately called this matter to Under Secretary Bell's attention, and he asked me to have Mr. Opie come in to see him at 12:30 today.

M. H.

300✓

June 9, 1941.

Mr. Chauncey:

The attached are for your file. The original of the letter approved by the President is in the official file in Mrs. Sullivan's office.

McGuire

Flourence

THE SECRETARY OF THE TREASURY
WASHINGTON

May 15, 1941

MEMORANDUM FOR THE PRESIDENT:

With your approval I have from time to time authorized the Federal Reserve Bank of New York as fiscal agent of the United States to open and maintain accounts for and in the names of the British, the Netherlands, the Canadian, and the Australian Governments. The doubt as to the authority of the Federal Reserve Bank of New York to maintain such accounts as principal rather than as fiscal agent has been removed by Section 14(e) of the Federal Reserve Act, as amended by the Act approved April 7, 1941. The Federal Reserve Bank of New York is now prepared to open and maintain such accounts under authority of Section 14(e) of the Federal Reserve Act.

Accordingly, if you approve, I propose to send the annexed letter to the Federal Reserve Bank of New York authorizing it to discontinue such accounts as fiscal agent of the United States. If you approve the foregoing, kindly indicate at the foot hereof.


Secretary of the Treasury.

APPROVED: May 15, 1941.





THE SECRETARY OF THE TREASURY
WASHINGTON

May 15, 1941

Dear Sir:

Reference is made to your letter of April 28, 1941, in which you state that appropriate action has been taken to authorize and approve the opening and maintaining by you as principal under authority of Section 14(e) of the Federal Reserve Act as recently amended, of accounts for and in the names of the British, the Netherlands, the Canadian and the Australian Governments, which accounts you are currently maintaining as fiscal agent of the United States.

This will confirm that you are authorized to discontinue the maintenance of such accounts as fiscal agent of the United States and that the Treasury has no objection to your opening and maintaining such accounts under authority of Section 14(e) of the Federal Reserve Act.

It is understood that you will continue the current procedure with respect to furnishing to this Department information concerning such accounts.

Very truly yours,



Secretary of the Treasury.

Mr. William Spraul, President,
Federal Reserve Bank of New York,
New York, New York.



DEPARTMENT OF STATE
WASHINGTON

In reply refer to
Co

May 15, 1941

CONFIDENTIAL

My dear Mr. Secretary:

I acknowledge with appreciation the receipt of Mr. Gaston's letter of May 5, 1941 describing the procedure being followed to test samples of gasoline being exported from the West Coast to Japan and enclosing copies of reports in regard to certain tests that were made. The Department is very glad to learn that this procedure is being followed and hopes that it will be continued as long as the present regulations governing the export of petroleum products remain in effect.

Sincerely yours,

For the Secretary of State:

Dean Acheson
Dean Acheson
Assistant Secretary

The Honorable

Henry Morgenthau, Jr.,

Secretary of the Treasury.

C
O
P
Y
May 5, 1941.CONFIDENTIAL

My dear Mr. Green:

Reference is made to your letter of March 29, 1941, your file Co, relative to the general procedure at Los Angeles in scrutinizing outgoing shipments of petroleum products, and in which you stated it would be desirable for customs authorities to have analyses made of occasional gasoline samples chosen at random from shipments about to be made.

The Commissioner of Customs on April 10, 1941, instructed the Collectors of Customs at Los Angeles and San Francisco (1) to secure a sample from each shipment of gasoline exported from their districts to Japan, (2) to have one out of five of such samples analyzed by reliable commercial analysts for determination of octane content, (3) to furnish copies of the analyses to the Bureau of Customs by air mail, and (4) to continue this practice until June 30, 1941.

There is transmitted herewith for your information a copy of a letter from the Assistant Collector at San Francisco, California, dated April 21, 1941, together with a copy of analysis made by E. W. Saybolt & Co., commercial analysts, from a sample of a cargo of gasoline laden on the M. S. KOKUYO MARU showing, with 3 cc of tetraethyl lead added, an octane content of 86.

There is also transmitted a copy of a letter from the Deputy Collector of Customs at San Pedro, California, dated April 22, 1941, together with a copy of analysis made by E. W. Saybolt & Co., of a sample from a cargo of gasoline laden on the MV KAIIZYO MARU showing an octane content of 69.

As of possible interest, there is also transmitted a copy of a letter from the Assistant Collector of Customs at Los Angeles, California, dated April 19, 1941, relative to exportation to Japan of crude oils having a very high octane content.

Very truly yours,

(Signed) Herbert E. Gaston

Assistant Secretary of the Treasury.

Mr. Joseph C. Green,
Division of Controls,
Department of State.

LS

GRAY

BERLIN

Dated May 15, 1941

Rec'd 10:32 a.m.

Secretary of State

Washington

1912, May 15, 10 a.m.

The rate of exchange between the German mark and Yugoslav dinar has been set at twenty dinars to the mark and for the Greek drachma at fifty drachmas to the mark. It is reported that with these favorable rates the occupying forces are buying up consumption goods in Yugoslavia and Greece in the same way as in the earlier occupied countries.

INFORM TREASURY.

MORRIS

RR

TREASURY DEPARTMENT
INTER OFFICE COMMUNICATION

DATE May 15, 1941

TO Secretary Morgenthau
FROM Herbert Merillat

HEARINGS OF WAYS AND MEANS COMMITTEE
Thursday, May 15, 1941

Beer tax

Committee sentiment seems to be strongly against increases in the present taxes on beer. Duncan, Dingell, and McKeough among the Democrats, and Crowther, Knutson, Reed, and Jenkins on the Republican side all gave clear indications that they opposed the proposed increase. Buck and Gearhart vigorously objected to the brewers' suggestion that the tax on fortified wines should be increased to bring it into line with the present beer tax, but regarded the brewers' case for no increase on beer sympathetically.

Excess Profits Tax

At various stages of the proceedings, Doughton and Robertson remarked that a large part of the prospective tax increases must be in the field of excess profits taxes.

Non-defense Spending

A long list of reductions in appropriations suggested by President Benson of Harding College, Arkansas, was received with enthusiasm by Republican members. Buck, Dingell, and McKeough

- 2 -

were inclined to be skeptical of the feasibility of making the broad slashes suggested by the witness. Doughton and Buck suggested that the proposals could better be directed to the Appropriations Committee.

Automobile Tax

A letter from the National Automobile Association, approving the proposal of a 50 per cent tax on car sales, was read into the record. Automobile dealers objected to any tax increase on automobiles. Doughton remarked that some increase must be made to compensate for the loss of revenue from this source resulting from reduced production of cars.

May 15, 1941

My dear Mr. President:

For your confidential information,
I am sending you herewith a statement
showing deliveries of airplanes through
May 10.

Yours sincerely,

(Signed) Henry

The President,
The White House.

Enc.

By Messenger / 2 '45

May 15, 1941

My dear Mr. President:

For your confidential information,
I am sending you herewith a statement
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May 10.

Yours sincerely,

(Signed) Henry

The President,
The White House.

By ~~Handwritten~~

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May 10.

Yours sincerely,

The President,
The White House.

By Messenger

STRICTLY CONFIDENTIAL

 DETAILED BY ASSIGNMENT, BY UNLOADING AND BY TYPE OF FLAME
 January 1, 1940 - May 10, 1941

UNIT AND PERIOD	Summers	Wintertime	Transfers	Other Military Changes	Commercial Clearance	Total
WHEEL AND TRANSPORTS						
Jan. 1 - June 22	528	900	606	100	719	2,313
June 23 - July 20	191	196	214	14	61	596
July 21 - Aug. 17	111	110	210	30	105	666
Aug. 18 - Sept. 14	112	200	192	20	98	622
Sept. 15 - Oct. 12	78	150	151	17	141	527
Oct. 13 - Nov. 7	136	184	161	16	82	654
Nov. 8 - Jan. 1	136	289	215	6	98	834
Subtotal June 23 - Jan. 1	640	1,325	811	100	462	3,068
Jan. 2 - June 22	40	47	164	4	16	305
June 23 - July 20	115	111	172	11	29	609
July 21 - Aug. 17	115	111	172	11	29	609
Aug. 18 - Sept. 14	100	102	102	10	21	527
Sept. 15 - Oct. 12	82	102	102	10	21	484
Oct. 13 - Nov. 7	100	116	102	10	21	484
Nov. 8 - Jan. 1	111	116	102	10	21	484
Subtotal June 23 - Jan. 1	111	116	102	10	21	484
Jan. 2 - June 22	7,375	2,678	5,164	113	1,763	15,233
NAVY						
Jan. 1 - June 22	26	31	443	61	-	561
June 23 - July 20	14	40	111	11	-	196
July 21 - Aug. 17	12	52	110	5	-	199
Aug. 18 - Sept. 14	12	58	103	7	-	199
Sept. 15 - Oct. 12	12	50	113	4	-	199
Oct. 13 - Nov. 7	8	14	129	2	-	153
Nov. 8 - Jan. 1	1	19	75	1	-	95
Subtotal June 23 - Jan. 1	74	302	984	70	-	1,384
Jan. 2 - June 22	6	6	66	4	-	98
June 23 - July 20	19	2	106	1	-	148
July 21 - Aug. 17	43	13	147	1	-	203
Aug. 18 - Sept. 14	43	13	147	1	-	203
Sept. 15 - Oct. 12	29	64	140	5	-	238
Oct. 13 - Nov. 7	29	64	140	5	-	238
Nov. 8 - Jan. 1	40	81	189	4	-	314
Subtotal June 23 - Jan. 1	159	317	800	24	-	1,200
Jan. 2 - June 22	307	118	1,037	139	-	4,008
RAIL						
Jan. 1 - June 22	42	1	74	35	-	156
June 23 - July 20	1	2	16	5	-	24
July 21 - Aug. 17	5	9	11	1	-	26
Aug. 18 - Sept. 14	10	9	17	1	-	37
Sept. 15 - Oct. 12	18	13	29	1	-	61
Oct. 13 - Nov. 7	17	11	45	1	-	74
Nov. 8 - Jan. 1	18	16	76	5	-	115
Subtotal June 23 - Jan. 1	66	75	297	74	-	539
Jan. 2 - June 22	17	14	73	5	-	115
June 23 - July 20	23	21	111	11	-	166
July 21 - Aug. 17	23	21	111	11	-	166
Aug. 18 - Sept. 14	23	21	111	11	-	166
Sept. 15 - Oct. 12	23	21	111	11	-	166
Oct. 13 - Nov. 7	23	21	111	11	-	166
Nov. 8 - Jan. 1	23	21	111	11	-	166
Subtotal June 23 - Jan. 1	117	117	577	74	-	895
Jan. 2 - June 22	23	21	111	11	-	166
June 23 - July 20	23	21	111	11	-	166
July 21 - Aug. 17	23	21	111	11	-	166
Aug. 18 - Sept. 14	23	21	111	11	-	166
Sept. 15 - Oct. 12	23	21	111	11	-	166
Oct. 13 - Nov. 7	23	21	111	11	-	166
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Sept. 15 - Oct. 12	23	21	111	11	-	166
Oct. 13 - Nov. 7	23	21	111	11	-	166
Nov. 8 - Jan. 1	23	21	111	11		

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE May 15, 1941

TO Secretary Morgenthau
FROM Mr. Goe^{MC}

Former Argentine Finance Minister Federico Pinedo will arrive in the United States by air on May 23. A Department of State official says the nature of his mission is not known. A United Press despatch from Buenos Aires reports that Pinedo may discuss the transfer of British interests in Argentina to United States control.

WITH THE COMPLIMENTS
OF
HAROLD K. HOCHSCHILD

Copy of Letter from B. Mexico City, May 15, 1941.

The Banco de Mexico is greatly alarmed over the outlook for the industries to secure raw materials which must be imported. The Bank prognosticates a general scarcity on account of defense activities in the United States and wishes to induce manufacturers to purchase large stocks. Most of the manufacturers are reluctant on account of (a) uncertainty of future price structures; (b) uncertainty as to future exchange positions; and (c) lack of cash to tie up in stocks. On point "b" we believe that the Government will make every effort to hold the exchange at 4.85, if possible. There has been an unusual offer of U.S. Cy. with little demand, and most of these Dollars have been absorbed by the Banco de Mexico. Regarding point "c", the Banco de Mexico is trying to induce the other Banks to extend their credit facilities to the industries. Point "a" is obviously beyond the control of the Bank and the manufacturers. We have mentioned this matter as quite a lot has been said and written about it recently. We, of course, are unable to judge the situation but believe that the Banco de Mexico may have a lot of reason for its attitude.

RECEIVED
Treasury Department
MAY 21 1941
Division of
Monetary Research

1429 local newspapers
1120 trade journals

5/18/41

Suggested letter from
Secretary Morgenthau to
Newspaper Publishers

Dear Mr. _____,

On May 1st we inaugurated a carefully considered plan for collecting the savings of the American people in the task of financing the National Defense Program.

Defense Savings Bonds and Stamps are now on sale in post offices and banks throughout the United States.

It is important that the Treasury Department reach - as often as possible - every home in the United States with information about these government obligations.

Through your newspaper, your assistance will be invaluable in our efforts to do this on a continuing basis. We should like to come to you from time to time with specific requests for co-operation.

If this meets with your approval, would you please designate someone on your staff to receive the Treasury Department material?

I shall look forward to hearing from you.

Very truly yours,

(Signed) H. MORGENTHAU, JR.

Secretary of the Treasury.

Approved by the Secretary 5/19/41

J.K.

1429 local newspapers
1120 trade journals

THE SECRETARY OF THE TREASURY
WASHINGTON



5/15/41

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Secretary Morgenthau to
Newspaper Publishers

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*How
time
time*

If this meets with
~~If we can have~~ your approval, would you please designate someone on your staff to receive the Treasury Department material?

look forward to
I shall appreciate hearing from you.

Very truly yours,

Secretary of the Treasury.

UNITED STATES SAVINGS BONDS AND SAVINGS STAMPS

CONFIDENTIAL

 Daily Sales Since May 1, 1941
 On Basis of Issue Price

(In thousands of dollars)

Date	All Bond Sales				Post Office Bond Sales	Bank Bond Sales				Savings Stamps
	Total	Series E	Series F	Series G	Series E	Total	Series E	Series F	Series G	
May 1941										
1 & 2	\$ 35,781	\$ 5,087	\$ 4,678	\$ 26,016	\$ 4,405	\$ 31,377	\$ 682	\$ 4,678	\$ 26,016	\$ 1,145
3	30,401	2,593	3,648	24,160	1,310	29,091	1,283	3,648	24,160	106
5	14,969	2,982	2,087	9,900	1,581	13,387	1,401	2,087	9,900	113
6	14,967	3,845	2,092	9,030	1,607	13,360	2,238	2,092	9,030	91
7	17,802	3,872	2,155	11,775	1,351	16,451	2,521	2,155	11,775	99
8	16,925	4,565	1,210	11,151	1,235	15,690	3,329	1,210	11,151	82
9	15,189	4,011	1,591	9,586	1,156	14,033	2,855	1,591	9,586	81
10	13,800	4,156	1,415	8,229	1,187	12,613	2,969	1,415	8,229	71
12	17,051	4,542	1,578	10,930	1,485	15,567	3,058	1,578	10,930	92
13	19,887	4,374	2,219	13,294	1,220	18,667	3,154	2,219	13,294	92
14	18,019	4,421	1,621	11,977	1,106	16,913	3,315	1,621	11,977	81
Total	\$214,791	\$ 44,449	\$ 24,295	\$146,048	\$ 17,644	\$197,148	\$ 26,805	\$ 24,295	\$146,048	\$ 2,054

Treasury Department, Division of Research and Statistics.

May 15, 1941.

Source: Division of Savings Bonds. The post office figures are estimated by the post office on the basis of actual sales by 100 larger post offices. The bank figures are taken from Federal Reserve Bank reports and include their own sales.

Note: Figures have been rounded to nearest thousand and will not necessarily add to totals.

May 15, 1941

Dear Mr. Hillman:

In connection with the Treasury's study of non-defense expenditures, it would be very helpful if we could get from the Office of Production Management, or from such agencies as are cooperating with your office, answers to the following questions:

1. What will be the increase in employment under the National Defense program in the approaching fiscal year, under present schedules of defense output? What will be the total industrial employment associated with these increases? How may we expect this increase in employment to be distributed by months? If similar data can be given for a period beyond the fiscal year 1941-42, that would be very useful.

2. What is the breakdown by major skilled and semi-skilled occupations of the above totals of increased employment?

3. What is the present supply of such skilled and semi-skilled persons: (a) among the unemployed; (b) among those now employed in non-defense production. (Any information on persons registered or working in jobs of lower skill than they could work at would be useful.)

4. What is the supply of such skills which will be forthcoming during the approaching fiscal year under the existing training programs of the Government and of private industry? What is the supply which is now coming forward? What supply has been trained since the defense training program was started.

I realize that any data or documents which you may provide us in answer to these questions will necessarily be subject to a

- 2 -

number of qualifications and reservations; those you may wish to have your staff indicate in brief accompanying statements.

Your cooperation in making available to us such information as you may have on these subjects will be greatly appreciated.

Very truly yours,

/s/ H. Morgenthau, Jr.

Secretary of the Treasury

Mr. Sidney Hillman,
Associate Director General,
Office of Production Management,
Social Security Building,
Washington, D. C.

VFC:ica
5/12/41

By Messenger

File to Mr. Thompson

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE

May 15, 1941.

TO Secretary Morgenthau
FROM J. J. O'Connell, Jr.

For your information

At the regular weekly meeting of the Price Administration Committee, held in Mr. Henderson's office this morning, there was a substantial amount of general discussion about the 85% loan farm bill which passed the Senate yesterday. Very few members seemed anxious to take any definite position as regards the legislation, all seeming to feel that, for better or worse, it is now an accomplished fact. Secretary Wickard, supported by Mr. Ezekiel, maintained that there has been much loose talk about the extent to which the increase in farm prices will affect the cost of living. His position is that the cost of living will be affected, but not nearly to the extent indicated by the opponents of the legislation. Mr. Ezekiel has detailed figures in support of this position which he is to distribute to the members of the Committee.

I asked Mr. Henderson, during the course of the discussion, what effect the enactment of this legislation would have upon his job, and also whether he favored it. Mr. Henderson declined to take a position, saying that time alone would tell what effect it would have upon his effectiveness, and that he did not care to express himself on the merits of the legislation. I discussed the question further with Mr. Henderson alone after the meeting. He was then quite frank to say that the action by the Congress was bound to make his job of keeping prices down much more difficult but he seemed inclined to be quite philosophical about the legislation itself. He stated that he did not see how, in the face of the vote, the President could be expected to veto the bill, and in fact indicated, in a general way, that he (Henderson) was not very much opposed to the legislation.

Secretary Morgenthau,

2.

During the meeting Mr. Henderson indicated great concern over the possibility of another stoppage of work in the bituminous coal industry. He suggested, for the consideration of the Committee, the desirability of making representations to the President to the effect that he request the Mediation Board to intervene again, in an attempt to forestall the threatened stoppage of work. He pointed out that the ramifications of another work stoppage on the price structure, not only of coal but of other things, are very great. I took the position that I did not feel that the Committee would be justified in urging the President to intervene in this situation, stating that I felt the President was sufficiently aware of the seriousness of the problem to act in the way that seems to him most effective, and that pressure from this group should not be brought into the picture in an effort to force his hand. Secretary Wickard expressed a similar view, based primarily upon the fact that he did not feel sufficiently acquainted with the problem to take the position suggested. No other members of the Committee expressed themselves one way or the other, and the matter was left hanging in midair. I gathered the impression that Mr. Henderson might make such a suggestion as the one indicated to the President, but that if so he would not state that his position had the support of the Price Administration Committee.

Mr. Henderson reported that his people have been having some general discussions with the Federal Reserve Board on the general problem of installment credit. He stated that the discussions had been very general and that he would keep me informed of all developments, as they had no intention of doing anything in the credit field without the complete support of the Secretary of the Treasury.

The balance of the discussion revolved around the general problem of bottlenecks in production. Apparently the feeling is becoming more and more prevalent that, pending expansion of productive capacity, more and more

Secretary Morgenthau,

3.

drastic curtailments of civilian consumption will be needed. For example, it is apparent now that because of shortage, if not the imposition of priorities or the direct curtailment of production, the automobile manufacturers will not be able to produce in the year beginning August 1, more than 60 per cent of this year's production, if that. Furthermore, it is beginning to dawn on those responsible for the defense effort, that it might be advisable to curtail production of this year's model, so as to save for defense purposes the materials that would otherwise go into automobiles between now and August 1 (obviously the situation does not apply to automobiles alone).

It was also reported to the meeting that there will probably be an acute shortage in nitrates within the next year. This is apparently the result of a combination of factors, chief among them being the problem of ocean transportation (Mr. Clayton advised that there are plenty of nitrates available in Chile), failure to get the necessary expansion in production in this country so far, and, of course, the great expansion in demand, both for civilian and defense needs.

Joseph J. O'Connell Jr

MAY 15 1941

My dear Senator:

I have your letters of May 8, 1941, addressed to me, Under Secretary Hall, Assistant Secretary Sullivan, Commissioner Droughton, and Dr. Klough, together with enclosures, concerning the efforts of your Committee to find ways and means of automatically balancing the Federal budget in times of peace.

I am having these matters studied and shall be glad to submit to you a report thereon as soon as the study has been completed. I know you appreciate that we are in the midst of a legislative program on taxes, and for that reason I hope you will bear with us if a report is not submitted immediately.

Sincerely yours,

(Signed) H. Morgenthau, Jr.

Secretary of the Treasury

Honorable Willard E. Wyding,
Chairman,
Special Senate Committee,
United States Senate,
Washington, D. C.

WJG:ELS
May 14, 1941

By Messenger 115

File to Mr. Thompson

WILLIAM E. TYDINGS, MD., CHAIRMAN
 GERALD R. NYE, N. DAK.
 ARTHUR H. VANDERBURGH, MISS.
 HENRY CABOT LODGE, JR., MASS.
 JAMES A. DANKFORD, CALIF.
 CHARLES W. TOMPKINS, N. H.
 WARREN R. AUSTIN, VT.
 EARL BAYLOR, ARIZ.
 ROBERT OGDEN CLARK, MD.
 ROBERT A. REYNOLDS, N. C.
 JAMES T. BURN, WASH.
 EDITH McFELLAR, TEXAS
 JOHN R. WHEELER, MONT.
 PETER G. WENY, N. I.
 JOHN C. MILLER, ARIZ.
 JAMES CHAYES, N. MEX.
 JIM MURDOCK, IOWA

United States Senate

COMMITTEE ON
TERRITORIES AND INSULAR AFFAIRS

May 5, 1941

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

Dear Mr. Secretary:

You perhaps have noted the efforts of the Senate Committee to find ways and means of automatically balancing the Federal budget in times of peace.

I am enclosing herewith a suggested bill and two suggested Constitutional amendments, each of which has been designed as a means to the end desired.

I would appreciate it greatly if, as soon as you find it convenient, you would look over these proposals, as well as examining the questionnaire herewith enclosed. The Committee would be very grateful if you would give us your answers to the questions propounded, and any other data which you feel would contribute to our further study.

It is likely that in the near future we will hold open hearings on this subject and would like to know if you desire to be called as a witness. We would be glad to have you, for we realize you could make a contribution to this subject which would be of value to us and the nation as a whole.

I trust we may hear from you at your early convenience concerning all these matters.

With best wishes, I am

Sincerely yours,

McClung
 Chairman, Special Senate Committee

A Suggested List of Questions for
the Senate Committee to Investigate
Federal Expenditures

(1) What, in your judgment, is the effect of a continuing unbalanced budget which results in an increase in the public debt?

(2) While the borrowing power of the federal government must be used to finance part of the national defense expenditures, what, in your opinion, is the safe limit of the public debt?

(3) What are your views concerning the new principle incorporated in this proposed legislation -- providing machinery for automatically raising revenues to balance the current budgets?

(4) Do you see any objection in Congress delegating administrative power to the Secretary of the Treasury to put into effect the flexible tax schedules constructed by Congress as provided for in this proposed legislation?

(5) If you believe in the automatic features provided for in the enclosed bill, do you think it ought to be given a more permanent status by writing it as a provision in the form of an amendment to the Constitution, which would thereby make it difficult for succeeding Congresses to repeal?

- (6) If you believe the automatic budget balancing principle ought to go into the Constitution, which of the two enclosed proposed constitutional amendments do you prefer; the one with broad powers, or the one with detailed provisions?
- (7) Do you think the 20 year period provided for in the proposed legislation is too long or too short a time interval in which emergency expenditures in excess of the budget will have to be liquidated?
- (8) What proportion of the national income, in any given year, do you think can safely be taken by the federal, state, and local governments in taxes? Is there a maximum?
- (9) Do you favor direct taxes or indirect taxes?
- (10) If you believe there should be both direct and indirect taxes, what proportion of the federal revenue should come from direct taxes (income) and what proportion should come from indirect taxes (like: (1) customs, (2) taxes on production, manufacturers' excise taxes, processing taxes, etc., (3) taxes on consumption, sale or transfer--sales taxes, based on vendors' returns and sales taxes collected through the sale of stamps, (4) estate and gift taxes, and (5) business privilege taxes).

- 3 -

(11) What are your views as to the federal government spending part of its funds by way of grants-in-aid to the states (as, for instance, relief appropriations, unemployment insurance, education, public roads, etc.)?

(12) While expenditures for national defense are rising in the face of large defense appropriations, do you believe we ought to continue or reduce non-defense expenditures, including those for public works?

(13) Do you think the prospect of inflation is hastened by virtue of an increasing unbalanced budget?

(14) What are your views as to the theory which has been propounded that there is no need to worry about the public debt since public expenditures increase the national income and promote the public welfare?

(15) What part will the proposed procedure for a balanced budget play in a period of post-war reconstruction?

[COMMITTEE PRINT]

77TH CONGRESS }
1st Session }

SENATE

{ REPORT
No. —

AN AUTOMATICALLY BALANCED BUDGET

APRIL —.—Ordered to be printed

Mr. TYDINGS, from the Special Committee to Find Ways and Means for an Automatically Balanced Budget, submitted the following

REPORT

[Pursuant to S. Res. 22]

FIRST COMMITTEE REPORT

The Special Senate Committee to Find Ways and Means for an Automatically Balanced Budget (Mr. Tydings, Mr. Thomas of Utah, and Mr. Holman) has directed the chairman (Mr. Tydings) to introduce in the Senate three proposals for an automatically balanced Federal Budget in times of peace.

The methods to accomplish this are two, one being an act of Congress and the other by a constitutional amendment.

There has been introduced a proposed law to accomplish an automatically balanced Budget and two constitutional amendments to accomplish the same purpose.

These proposals will be submitted to outstanding persons in the field of budgetary matters, and in the future it is not unlikely that hearings will be held, in order to develop criticism of defects and weaknesses in the proposals outlined, to the end that they may be perfected and the desired objective attained.

The proposals introduced are outlines only and no doubt will need considerable improvement, in the light of further examination. The proposed law comprehends the following:

(1) It is suggested that the average annual cost of the National Government for the period from July 1, 1930, to July 1, 1940, be definitely ascertained, and that this figure be known as the "annual normal Federal expense."

(2) The amount of money which the Congress annually appropriates automatically determines the amount of taxes to be levied by the National Government in order to meet the appropriations.

(3) Consequently, it will be necessary for Congress to adopt and have in being various schedules of taxation. Schedule A, for example, would raise sufficient money to provide for the "annual normal Federal expense." Schedules B, C, D, etc., would provide for additional

expenditures over and above "annual normal Federal expense," in such years when Congress appropriated greater sums.

(4) Once the total of annual appropriations is known, the schedule automatically goes into effect which will raise sufficient money to take care of said appropriations.

(5) If because of a dull business year, or for any other reason, the schedule in effect does not raise sufficient money to provide for the year's appropriations, then the deficit thus created must be the first charge on the following year's revenue and be considered in adopting the automatic schedule of revenues for the following year.

(6) In the event that the schedule in effect raises more money than is necessary to take care of the year's total appropriations, the excess is automatically applied to the liquidation of the national debt.

(7) In years of great depression or extraordinary peacetime preparedness expenditures or any other abnormal governmental financial outlay, Congress can escape providing for such extra financial burden currently; it can provide for the payment of the extra burden over a period of not more than 20 years for the gradual liquidation of the deficit for any year. It may even provide that a hiatus of 2, 3, 4, or 5 years may run before taxes to liquidate the deficit created by the extra burden shall begin to be collected so as to liquidate it entirely in not more than 20 years from the date of its creation.

An illustration of some of the differences between the schedules might be comprehended as follows: Schedule *A* would provide for an income-tax exemption for married people with no children of \$2,400. Schedule *B* might provide for the exemption to begin at \$2,300, and schedule *C* for it to begin at \$2,200. Thus, in the drafting of a law the schedules themselves could not very well be included, but there would have to be enough of a description of the schedules so that the law would clearly show what is intended by the various schedules and to have the one that goes into effect any year take care of that year's appropriations.

CONSTITUTIONAL AMENDMENTS

The constitutional amendments are in two forms—*one*, a short amendment; the other, a long amendment.

The short amendment simply provides that the public debt of the United States shall not be ever greater than what is the amount of the national public debt at the time the constitutional amendment is adopted, unless additional taxes to take care of such addition in the national debt are provided, which will liquidate said debt within a period of 20 years from the date of its creation.

The long constitutional amendment follows the same general philosophy and speaks for itself.

In addition to the plans herewith submitted, the committee will entertain suggestions of other plans which are intended to accomplish the same result.

M. E. TYDINGS, *Chairman*.

[COMMITTEE PRINT]

APRIL 29, 1941

77TH CONGRESS
1ST SESSION**S.**

IN THE SENATE OF THE UNITED STATES

APRIL 29, 1941

Mr. TYDINGS (for the committee) introduced the following bill; which was read twice and referred to the Committee on

A BILL

To provide for a balanced Budget.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That (a) the Congress hereby finds that continued deficit
4 financing and the mounting public debt are matters of
5 grave national concern; that a balanced Budget as soon as
6 practicable is as necessary to our continued form of gov-
7 ernment as an adequate national defense; and that a pay-
8 as-you-go basis, although entailing great hardship and sac-
9 rifice, is of such paramount importance as to no longer
10 permit delay in the matter.

11 (b) It is hereby declared to be the policy of this Act

J. 313715—A

1 to secure permanent financial stability for the United States
2 Government by providing the machinery for an automati-
3 cally balanced Budget.

4 SEC. 2. (a) There shall be enacted as soon as prac-
5 ticable after the date of enactment of this Act a schedule
6 of taxation, to be designated Schedule A, imposing such
7 taxes, duties, imposts, or excises as will raise an amount
8 of revenue with respect to any calendar year equal to the
9 average annual expenditures of the United States for the
10 period July 1, 1930, to June 30, 1940, both dates inclusive.

11 (b) There shall also be enacted as soon as practicable
12 after the date of enactment of this Act fourteen other
13 schedules of taxation, to be designated Schedules B, C, D,
14 E, F, G, H, I, J, K, L, M, N, O, respectively. Each
15 such schedule shall impose such taxes, duties, imposts, or
16 excises as will raise an amount of revenue with respect to
17 any calendar year 5 per centum greater than the amount
18 that would be raised by the schedule immediately preceding it.

19 (c) Each such schedule of taxation shall contain varying
20 rates of taxes, duties, imposts, and excises; shall provide
21 different exemptions and credits; shall be in simplified form
22 and written in clear and concise language; and shall follow
23 a basic pattern with respect to penalties, procedure, adminis-
24 tration, and the imposition and collection of such taxes, duties,
25 imposts, and excises.

1 SEC. 3. (a) Beginning with the calendar year 1943,
2 and for each calendar year thereafter, there shall be in
3 effect as of January 1 of each such year such schedule of
4 taxation, enacted under section 2, as the Secretary of the
5 Treasury estimates will raise an amount of revenue with
6 respect to such year (1) equal to the amount of money
7 appropriated during the preceding calendar year for the
8 normal peacetime expenses of the United States plus (2)
9 the amount of any deficit created during such preceding
10 calendar year because the amount of revenue raised for
11 such year was less than the amount estimated by the Secre-
12 tary of the Treasury. The amount of any such deficit shall
13 not be considered by the Secretary in estimating the amount
14 of revenue to be raised for the calendar year 1943. If
15 for any such year the amount of revenue so raised is more
16 than the amount so estimated, the excess shall be used to
17 reduce the public debt.

18 (b) On or before December 31 of each year, the Secre-
19 tary of the Treasury shall specify the schedule of taxation
20 which he estimates will raise the required amount of revenue
21 for the succeeding calendar year and the schedule so speci-
22 fied shall be published in the Statutes at Large and the
23 Federal Register.

24 SEC. 4. No money shall be appropriated by the Con-
25 gress for emergency or wartime expenses of or expenditures

1 by the United States unless the law appropriating such
 2 money contains such schedule of taxation, enacted under
 3 section 2, as the Secretary of the Treasury estimates will
 4 raise an amount of revenue, within a period of not more than
 5 twenty years after such appropriation is made, equal to the
 6 amount of money so appropriated. If the Secretary finds
 7 during such period that such schedule will raise an amount
 8 of revenue less than the amount of money so appropriated,
 9 he shall transmit such finding to the Congress, and such
 10 additional schedule of taxation, enacted under section 2, as
 11 the Secretary estimates will raise an amount of revenue,
 12 within such period, equal to such estimated deficit, shall take
 13 effect on the first day of the month following such trans-
 14 mission. All amounts of revenue so raised during such
 15 period shall be used to reduce the public debt.

[COMMITTEE PRINT]

APRIL 29, 1941

77TH CONGRESS
1st Session**S. J. RES.**

IN THE SENATE OF THE UNITED STATES

April, 1941

Mr. TYNEN (for the committee) introduced the following joint resolution; which was read twice and referred to the Committee on

JOINT RESOLUTION

Proposing an amendment to the Constitution of the United States to provide for a balanced Budget.

1 *Resolved by the Senate and House of Representatives*
 2 *of the United States of America in Congress assembled*
 3 *(two-thirds of each House concurring therein), That the*
 4 *following article is hereby proposed as an amendment to the*
 5 *Constitution of the United States, which shall be valid to all*
 6 *intents and purposes as part of the Constitution when ratified*
 7 *by the legislatures of three-fourths of the several States:*

8 "ARTICLE —

9 "SECTION 1. (a) No money shall be appropriated by
 10 the Congress during any calendar year for the annual normal

J. 313715—C

[COMMITTEE PRINT]

APRIL 29, 1941

77TH CONGRESS
1st Session**S.****A BILL**

To provide for a balanced Budget.

By Mr. TYNEN

April, 1941

Read twice and referred to the Committee on

1 peacetime expenses of the United States unless a law effective as of January 1 of such year imposes taxes, duties, imposts, or excises for such year which the Secretary of the Treasury estimates will raise an amount of revenue equal to (1) the amount of money appropriated for such expenses during the preceding calendar year plus (2) the amount of any deficit created during such preceding calendar year because the amount of revenue raised for such year was less than the amount estimated by the Secretary of the Treasury, except that the amount of any such deficit shall not be considered by the Secretary in estimating the amount of revenue to be raised for the first calendar year to which this section applies. If for any year the amount of revenues so raised is more than the amount so estimated, the excess shall be used to reduce the public debt.

16 “(b) No money shall be appropriated by the Congress for emergency or wartime expenses of or expenditure by the United States unless the law appropriating such money contains a provision imposing such taxes, duties, imposts, or excises as the Secretary of the Treasury estimates will raise an amount of revenue, within a period of not more than twenty years after such appropriation is made, equal to the amount of money so appropriated. If the Secretary finds during such period that such provision will raise an amount of revenue less than the amount of money

1 so appropriated, he shall transmit such finding to the Congress, who shall, as soon as practicable thereafter, enact a law imposing such additional taxes, duties, imposts, or excises as the Secretary estimates will raise an amount of revenue, within such period, equal to such estimated deficit. All amounts of revenue so raised during such period shall be used to reduce the public debt.

8 “(c) If on January 1 of any calendar year the public debt is less than \$10,000,000,000, the provisions of this section requiring the imposition of taxes, duties, imposts, or excises shall become and remain inoperative until the next succeeding calendar year at the beginning of which such debt is \$10,000,000,000 or more.

14 “SEC. 2. The provisions of section 1 shall take effect on the 1st day of January of the second year beginning after the year during which this article is ratified.

17 “SEC. 3. This article shall be inoperative unless it shall have been ratified as an amendment to the Constitution by the legislatures of three-fourths of the several States within seven years from the date of its submission to the States by the Congress.”

[COMMITTEE PRINT]

APRIL 29, 1941

77TH CONGRESS
1st Session

S. J. RES.

IN THE SENATE OF THE UNITED STATES

APRIL 29, 1941

Mr. TRONNES (for the committee) introduced the following joint resolution; which was read twice and referred to the Committee on

JOINT RESOLUTION

Proposing an amendment to the Constitution of the United States limiting the size of the public debt.

1 *Resolved by the Senate and House of Representatives*
2 *of the United States of America in Congress assembled (two-*
3 *thirds of each House concurring therein), That the following*
4 *article is hereby proposed as an amendment to the Constitu-*
5 *tion of the United States, which shall be valid to all intents*
6 *and purposes as part of the Constitution when ratified by the*
7 *legislatures of three-fourths of the several States:*

8 "ARTICLE —

9 "SECTION 1. (a) The public debt of the United States
10 shall not exceed the limitation in amount imposed by law

J. 313715—B

[COMMITTEE PRINT]

APRIL 29, 1941

77TH CONGRESS
1st Session

S. J. RES.

JOINT RESOLUTION

Proposing an amendment to the Constitution of the United States to provide for a balanced Budget.

By Mr. TRONNES

APRIL 29, 1941

Read twice and referred to the Committee on

1 on the date of ratification of this article unless each law
 2 authorizing an increase in the public debt in excess of such
 3 limitation contains a provision imposing such taxes, duties,
 4 imposts, or excises as will raise an amount of revenue, within
 5 a period of not more than twenty years after the enactment
 6 of such law, sufficient to pay the principal and interest of such
 7 increase. Until the principal and interest of such increase
 8 shall have been paid in full, such provision imposing taxes,
 9 duties, imposts, or excises shall not be repealed and the
 10 revenue so raised shall not be used for any other purpose.

11 (b) No such law authorizing such an increase in the
 12 public debt shall be effective for a period of more than
 13 twenty years after such law is enacted.

14 "SEC. 2. This article shall be inoperative unless it shall
 15 have been ratified as an amendment to the Constitution
 16 by the legislatures of three-fourths of the several States
 17 within seven years from the date of its submission to the
 18 States by the Congress."

JOINT RESOLUTION

21 RES.

TREASURY DEPARTMENT

INTER-OFFICE COMMUNICATION

DATE May 15, 1941.

TO Secretary Morgenthau

FROM Mr. Cochran

CONFIDENTIAL

Registered sterling transactions of the reporting banks were as follows:

Sold to commercial concerns	£25,000
Purchased from commercial concerns	£17,000

Open market sterling was quoted at 4.03-1/4. Transactions of the reporting banks were as follows:

Sold to commercial concerns	-0-
Purchased from commercial concerns	£ 9,000

The Cuban peso again moved to a new current high of 2-1/16% discount.

In New York, closing quotations for the foreign currencies listed below were as follows:

Canadian dollar	13-1/16% discount
Swiss franc	.2321-1/2
Swedish krona	.2385
Reichsmark	.4005
Lira	.0505
Argentine peso (free)	.2375
Brazilian milreis (free)	.0505
Mexican peso	.2066

In Shanghai, the yuan was again quoted at 5-11/32¢. Sterling was unchanged at 3.90-7/8.

There were no purchases or sales of gold effected by us today.

The Treasury issued licenses under both the Gold Reserve Act and Executive Order No. 8389, as amended, permitting the Federal Reserve Bank of New York to effect the following transfer of gold in its vaults:

\$1,126,000 from B.I.S. account no. 2 to the account of the Bank of Portugal.
Gold in B.I.S. account no. 2 is owned by that bank.

No new gold engagements were reported.

- 2 -

In London, the price fixed for spot silver was 23-7/16d, off 1/16d. The forward quotation was unchanged at 23-1/2d. The U.S. equivalents were 42.56¢ and 42.67¢ respectively.

The Treasury's purchase price for foreign silver was unchanged at 35¢. Handy and Harman's settlement price for foreign silver was also unchanged at 34-3/4¢.

We made three purchases of silver amounting to 125,000 ounces under the Silver Purchase Act. This consisted of new production from various foreign countries, and was bought for forward delivery.

**CONFIDENTIAL**

RESTRICTED

G-2/2657-220; No. 392 H.I.D., W. D. 12:00 M., May 15, 1941.

SITUATION REPORTI. Western Theater of War.

Air: Bad weather prevailed; very low air activity on both sides.

II. Mediterranean and African Theaters of War.

Ground: North Africa. Axis forces have withdrawn to original positions in the vicinity of Sollum following deep reconnaissances to the East and Southeast.

East Africa. British troops have occupied Algi, an Italian post about 50 miles north of Iavello in southern Abyssinia (Ethiopia).

Air: Axis. Raids on Tobruk, Malta and Crete.

British. Derna was attacked.

III. Iraq.

No change in the ground situation.

A limited number of German aircraft, bombers, fighters and transports are now in action.

RESTRICTED