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May 16, 1941  
9:00 a.m.

RE TAXES

- Present: Mr. Sullivan
- Mr. Shoup
- Mr. Helvering
- Mr. Foley
- Mr. Greenbaum
- Mr. Kades
- Mr. Knollenberg
- Mr. Blough
- Mr. Bell
- Mr. Kuhn
- Mrs. McHugh
- Mr. Gaston

H.M.Jr: All right, Roy. (Mr. Blough handed copy of draft of Tax Statement to Secretary.)

Now, Blough.

Blough: Read?

H.M.Jr: How much sleep did you have?

Blough: Plenty.

H.M.Jr: Did you? You must get along with very little.  
(Mr. Gaston entered the conference.)

Blough: Just for one night.

H.M.Jr: Everybody is here but Sullivan. Let's go.

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Blough: "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."

H.M. Jr: Excuse me. If and when you come to something that is different than last night, will you let me know? When you come to a change and remember, will you say, "I am going to read a change"?

(Mr. Sullivan entered the conference.)

Blough: Yes.

"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 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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"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 clauses that are appropriate to easier occasions but today will defeat our ends."

H.M. Jr: Wait a minute. "Saving clauses." Go ahead.

Blough: "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 are excess profits by any reasonable standards."

And that was a slight change in wording at that point.

"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

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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 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 the next sentence, "majority" is changed to "many".

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."

At this point, this sentence was cut out. "Some relief can and should be granted where it is clear that this is not the case."

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"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."

And that is changed from "some incomes not due to the defense program."

"2. Profits in excess of a necessary normal 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 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."

At this point the following sentence was eliminated: "These profits represent in large part money taken from the consumers in excess of the amount necessary to produce the goods or services."

"When the imperfection 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.

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"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 every 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."

There is a slight change here. These words have been added: "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."

- Bell: Where you say "subject to a heavy tax", would it emphasize more if you said, "now subject to a much heavier tax"?
- Blough: It might be, although it isn't always true. You mean "now subject to a much heavier tax than before"?
- Bell: Yes. You see you are comparing what he says now with what they have been paying.
- Blough: Good.

H.M.Jr: Who has the July 8 statement? Somebody took it off my desk.

Foley: I gave it to Eddie. What did you do with it, Eddie?

Greenbaum: I put it on the table back here yesterday afternoon.

Foley: That is the one you got last night.

Kades: I will get another copy.

H.M.Jr: Get a copy which goes for the President, you see.

Foley: Have it run.

H.M.Jr: Have it run and give it to Mrs. McHugh.

Kades: Yes, sir.

H.M.Jr: Now, just a second. If there are going to be any changes, they will have to be made on each page now as we go along. I won't explain it, but there will be no more changes, so if anybody has got anything - I take it that this is the copy here that goes to the President.

What?

Blough: Mr. Bell had one suggestion.

Bell: Not very important.

Blough: The first paragraph on page six, next to the last line, "an individual's expectation of a continued large salary, now subject to a heavier tax," the idea that it has been increased.

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H.M.Jr: Wait a minute. I am not with you. Page six, what?

Blough: Page six, first paragraph, next to the last line, where it is said that "an individual's expectation of a continued large salary--"

H.M.Jr: I still don't see. What paragraph is that?

Blough: First paragraph. "Now subject to a heavy tax", just before the last sentence.

H.M.Jr: Yes.

Blough: "Now subject to a heavy tax." He points out that it - that it would be more in keeping with the rest of it if it said "now subject to a much heavier tax."

H.M.Jr: I didn't get the point.

Blough: What I said was, "The taxes are being changed and we shouldn't worry too much about that," and Mr. Bell points out that if this said, "now subject to a much heavier tax than formerly," or something like that, "that it might carry more--"

H.M.Jr: Well, what do you think?

Foley: I think that is a good change.

Bell: It is not very important, but what you are trying to do, I take it, is point out that the individual has now had his taxes raised way up whereas these particular corporations are not being hit in this period like the individuals. I just thought "much heavier at this time" would emphasize that point. I don't think it is terribly important.

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Greenbaum: I think it is worth changing, because it does emphasize it.

H.M.Jr: What has happened to Kades?

Foley: He went to get the July 8 statement.

H.M.Jr: Who will correct this, so I can give it to somebody to correct.

Foley: I will do it. Are you going to have the first page run again with that change?

H.M.Jr: What change on the first page?

Foley: Well, there is a typographical error, isn't there?

H.M.Jr: Well, that doesn't bother me. Are you just going to change that, Ed?

Foley: Yes, make it "heavier."

H.M.Jr: Is that all there is?

Foley: Yes. Isn't that right, Dan?

Bell: That is all right.

Knollenberg: "Than before". It might sound as if it is heavier than this excess profits tax.

Gaston: If you are going to change it, you might as well make it "now to be subject to a much heavier tax." I think what you are thinking about is the new law that isn't the law yet.

Foley: All right, "now to be subject to a much heavier tax."

Blough: Do you need a "than" in there?

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Gaston: No.

Blough: All right.

H.M.Jr: Where were we, Roy?

Blough: We were ready for roman two at the bottom of page six.

H.M.Jr: Just read the rest of that page and we will send out page six.

Blough: "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."

H.M.Jr: Now, just a minute.

Bell: Want me to take it?

H.M.Jr: No.

Sullivan: Is page five out?

H.M.Jr: Oh, God! We have got to get this at ten o'clock. There is a limit to what we can do. I have got to get this thing over there.

What is it, John?

Sullivan: It isn't important.

H.M.Jr: I mean, how am I going to get this to the President? And I want to see the last part, which is the most important.

Sullivan: Very much so.

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Foley: We can get it over. They can run these pages as we change them.

Blough: I can read faster if you like.

H.M.Jr: No, it is all right, but I know that we are going to have trouble with the end, and I want to get to that.

Blough: "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."

Greenbaum: Mr. Secretary, how would it be just to go over the changes and not read the rest of it?

H.M.Jr: I want Bell to get it. Go ahead.

Blough: "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

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of 1940, although steel companies have in general received huge amounts of defense orders."

H.M.Jr: Now, just stop there a minute.

Sullivan: We mentioned steel twice. If you wanted to take "steel" out the first time, I don't think you would lose anything. Say, "A large company which has received over \$250 million," because then later on you talk about steel companies. It looks as though we are rather riding them.

H.M.Jr: They said the same thing. How would you change it?

Sullivan: Just say, "A large company." Take out "steel."

H.M.Jr: We can just cross that out. That is easy.

Sullivan: Yes. There is no need of doing the page over.

H.M.Jr: You mean just leave out the word "company"?

Sullivan: No, "A large company."

H.M.Jr: All right. That is done.

Foley: Don't you want that rerun.

H.M.Jr: No.

Dan, have you got anything?

Bell: Do you give the reasons? I see, the next paragraph gives the reasons.

H.M.Jr: Yes. Go ahead.

Blough: "These companies pay little or no excess profits

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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.

"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 - " and there is a slight change here - "a 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.

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"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."

- H.M.Jr: Just a moment. "To be allowed tax free their earnings"?
- Blough: It really was an amount equal to their earnings during the base period.
- H.M.Jr: Is that clear?
- Blough: Free from excess profits tax an amount equal to their earnings during the base period would be more precise.
- H.M.Jr: A corporation would be allowed tax free their earnings?
- Kuhn: "To be allowed their earnings, tax free," isn't that a better way of putting it?
- Bell: "Their earnings during that period would be tax free."
- Foley: It all depends on the way you say it, Mr. Secretary.
- Blough: Put a hyphen in "tax free".
- Foley: It reads all right if you drop your voice.
- H.M.Jr: Thank you. O.K.
- Blough: "However, they were granted a minimum credit of 4 percent of invested capital with 6 per-

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cent allowed on the first \$500,000. Thus, under that plan - " instead of the Treasury plan, to make sure that it is last year's plan - "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 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."

H.M.Jr: John?

Sullivan: It is all right.

Blough: "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 - " a slight change to make sure we have the right plan - "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."

Now, we will have to say "one of the large companies," instead of "a large steel company."

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H.M.Jr: Wait a minute.

Greenbaum: Could you describe it as a large company which received two hundred fifty million in defense orders?

H.M.Jr: Why not put it this way, Ed? "The large company which received such-and-such a contract."

Foley: Right.

Greenbaum: Yes, we are making just the same correction.

H.M.Jr: "The large company that received the - " what was it you said?

Greenbaum: "Two hundred fifty million of defense contracts," that is the way we described it before.

H.M.Jr: Yes, that is right.

Blough: It is over two hundred fifty.

Gaston: You don't need "large." "The company that received it."

Foley: "The large company which received it."

H.M.Jr: Well, you call it "the large," don't you?

Greenbaum: I would like to repeat the same phrase. It ties right in, then.

H.M.Jr: I would repeat. "The large company which received--"

Blough: "Over two hundred fifty million dollars of defense contracts."

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H.M.Jr: You can avoid both of them in the first instance if you call it a large industrial company.

Blough: What about that?

Sullivan: Oh, it has gone out now.

Greenbaum: No, that page wasn't changed.

Sullivan: I have another thing on this page that bothers me. "The corporation which has the forty percent." It looks as though we are gunning for one company. Now, there were several that had forty percent, Roy.

Blough: Well, the examples mentioned it.

H.M.Jr: How would you change it?

Kuhn: I would leave it.

H.M.Jr: Read me ten before it goes out.

Foley: "The large company which received over two hundred fifty million of defense contracts would have paid excess profits 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."

H.M.Jr: All right.

Foley: O.K.?

H.M.Jr: Yes.

Bell: Do you mean to be put in there "under the present law"? "Being exempt under the present law," is that what you mean? The last line.

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Blough: Yes, instead of both companies being entirely exempt under the present law - is page ten gone out finally?

Foley: Yes, I gave it to her. What do you want changed?

Blough: Mr. Bell suggests, "under the present law" be added to the last line.

H.M.Jr: Shall we leave it as it is?

Gaston: "As under the present law." I don't think it is necessary.

Knollenberg: I don't either.

Bell: O.K.

H.M.Jr: If it isn't necessary--

Gaston: It isn't necessary.

Bell: I just thought some of them might raise the question as to whether it was under a pending bill. O.K. I wouldn't change it.

Foley: I think when you say "would have had--"

H.M.Jr: Well, what do you think? Are you all right? Want to change it?

Knollenberg: I think it is clear. We spoke about "previously presented," which were these companies under the present law.

H.M.Jr: Want to press for it, Bell, or not?

Bell: No.

H.M.Jr: O.K., we will let it go.

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Blough: "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."

H.M.Jr: John?

Sullivan: All right.

H.M.Jr: Go ahead.

Blough: "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."

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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 much more easily to a need for still larger revenues if the emergency should so require."

From now on we have new material in this paragraph.

"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 time than to patch up the present law only perhaps to find ourselves confronted with the necessity of improvising such a base on short notice at a later date."

Sullivan: I like that very much.

H.M.Jr: Very good.

Blough: "IV. Possible but not preferred alternative

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H.M.Jr: Now wait a minute.

Blough: That "but not preferred" was added as suggested last night.

H.M.Jr: Let it just sink in a minute.

Sullivan: Then I think Mr. Knollenberg afterward--

Knollenberg: I afterward changed my mind and said to cut it out.

Blough: Oh, I am sorry.

Knollenberg: Never mind.

Foley: I like it. (Laughter)

Sullivan: I do.

Foley: Next best to taking it out entirely.

Sullivan: I am for taking it out.

Foley: I mean from there on.

H.M.Jr: That is what I wanted to say in the few minutes we had left. Let's take a look at it the way it reads. Just see what the possible but not the preferred looks like.

Sullivan: Don't let that phrase go out.

H.M.Jr: All right.

Blough: "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

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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."

- H.M.Jr: Now wait a minute.
- Gaston: There are too many "believes" I think.
- H.M.Jr: Well, Herbert, I am not going to have patience. That kind of thing we could do over.
- Sullivan: That is right.
- H.M.Jr: I mean, you are perfectly right, Herbert, but I am not going to do over a page now.
- Bell: It seems to me that that whole paragraph belongs at the end of the preceding section. You haven't said anything in that paragraph about what you are going to propose here. You are talking about what you have said in the past, aren't you?
- Knollenberg: I wanted it cut out for that reason last night, but I think maybe yours is sounder, to let it in and change the heading. You are panting to find out what is the alternative and then you have this whole paragraph. I suggest we cut it out.
- Gaston: No, I think it is a transition that introduces your alternative. I think it belongs in the--
- Shoup: You don't want them to come to the point with this alternative.

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H.M.Jr: Is that all new?

Greenbaum: No, this is the same as on page fourteen.

Foley: He is fixing it up.

Knollenberg: When it is run off, Mr. Secretary, you will agree with it.

Sullivan: I won't.

Greenbaum: If you could see it on paper. It would be the same as on fourteen with a certain part moved from fourteen to thirteen.

H.M.Jr: Let me run through the rest of this. He read down to, "If these principles are not to be the guide."

Blough: Yes. Now, this next paragraph has more changes in it than all the rest put together.

H.M.Jr: Let's just hear them.

Blough: "If these principles are not to be the guide for taxing 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."

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- H.M.Jr: Go on, just read through to the end.
- Blough: "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 - " it should be taxation to individuals.
- Sullivan: "Of individuals."
- Knollenberg: "Taxation of income to individuals."
- H.M.Jr: Let's let it go the way Knollenberg says it.
- Blough: "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.
- "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.
- "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."
- H.M.Jr: Now I am open to suggestion.

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- Sullivan: I don't mind whether that heading is moved down one paragraph later, but I would like to have the "not preferred" taken out.
- H.M.Jr: Do you want it "possible preferred alternative"?
- Sullivan: No, just "possible alternative."
- H.M.Jr: Well, you want it how, John?
- Sullivan: Just "possible alternative." Whether it is moved down one paragraph or not doesn't make any difference to me.
- H.M.Jr: I see. I think that that would be better down in that heading, Roy.
- Blough: It is immaterial to me, I am sure.
- H.M.Jr: What do you think?
- Gaston: I don't think it matters.
- H.M.Jr: Ferdie?
- Kuhn: No, it doesn't matter. I had one point to raise about the whole of the alternative suggestion.
- H.M.Jr: Now, what was this thing, Eddie, that you had?
- Greenbaum: The reason for this is that at the top of page fourteen, in my opinion, it damns your major proposal. You are saying it has disadvantages of administrative difficulties, and then you are patting the other plan on the back saying it is more easily administered and it is simpler.
- Kuhn: You are saying "it should, in my judgment," which

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implies a kind of approval of the alternative which we don't like.

Greenbaum: Therefore, my suggestion is, and then, and only then I think it is important to change that heading four, would be to add at the end of paragraph on thirteen the thought that you are getting in on fourteen so it would read as follows after full paragraph on fourteen:

"Nor should we be deterred by the fact that administrative difficulties exist. It is believed that experience will aid in solving many of them.

"IV. Possible alternative

"If these principles are not to be the guide for taxing corporations during the emergency period, then, and only then, should consideration be given to an alternative plan which it should be noted necessarily can reach only part of the profits that it should reach. Such a plan would have the advantage of simplicity but would, of course, abandon the principle of excess profits tax."

Then it would go on.

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

Blough: I have no objection to it with one exception. What you are leading up to is some plan for altering the present law which doesn't reach all the profits it should, and the plan that is proposed here reaches more profits than the major proposal does, so that that phraseology, it seems to me, would not be an accurate statement.

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- Knollenberg: Yes.
- Greenbaum: It would reach different problems.
- Gaston: This is on a different basis.
- Blough: If we are going to put Mr. Sullivan's proposal in as an alternative, your language would be excellent in introducing it.
- Greenbaum: Well, such a plan would have the advantage of simplicity but would, of course, abandon the principle of the excess profits tax.
- Sullivan: We have already said that, Mr. Greenbaum, We have already said, "If these principles are not to be your guide."
- Greenbaum: Well, that criticism is true, but it is also ture in the present draft. Then it would go on, "This plan would be to increase the corporation income tax by enough to produce the desired income." And then it would be the same as you have it. My major point is, and the only reason I am making the suggestion, particularly at this late hour, is that I do think that the way this is phrased now, you are not only damning your own thing, but you are implying the approval of that alternative.
- Kuhn: If the public gets the impression that the Treasury is really backing this alternative with the undistributed profits tax as part of it, there will be a commotion which we don't want. We are using the defense emergency to put over something which we weren't able to put over five years ago. We are creating new dissensions when we shouldn't be. I think we ought to make it perfectly clear that we only throw this out as something worse than what we would like.

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Knollenberg: Would you be willing to stop on page fourteen, the fourth line - there is that clause which says "but applies only to part of the profits that it should reach"? Now that is a somewhat damaging phrase about the excess profits tax.

Shoup: In its present form.

Knollenberg: Oh! Well, then why don't we say that, to make sure that it is not excess profits taxation in general. "And which in its present form."

Shoup: "Of this tax. Which involves the administrative difficulties of this tax."

Knollenberg: But if we stick in this present tax, you see, Eddie's point is that this seems to damn the principle of excess profits tax.

Blough: Oh, I am sorry, we didn't mean to - your criticism is well taken, but couldn't it be met by saying "it might be well to consider carefully the disadvantages of the present tax"?

Shoup: "The tax in its present form."

Blough: "Of the tax in its present form which involves administrative difficulties while applying only to part of the profits that it should reach."

Knollenberg: That cures it.

Bell: Put "and" instead of "but." "And applies to only part of the profits."

Blough: "It might be well to consider carefully the disadvantages of the tax in its present form which involves administrative difficulties and applies--"

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Knollenberg: "And yet applies."

Blough: "And yet applies only to--"

Greenbaum: "And does not reach - and reaches only part of the profits that it should reach."

Shoup: "Fails to reach all the profits it should."

Blough: Well, which of these is better?

H.M.Jr: Well, Roy, you do it. You have been doing it. Do one that satisfies you.

Greenbaum: He should get his language.

Blough: "It might be well to consider carefully the disadvantages of the tax in its present form--"

Greenbaum: "Which not only involves administrative difficulties--"

H.M.Jr: Give him a chance, Eddie.

Blough: "Which not only involves administrative difficulties but fails to reach--"

Greenbaum: "Profits that it should reach."

Bell: "But reaches only a part."

Greenbaum: "Of the tax."

Blough: Are we willing to say "large amounts of profits that it should reach"? Well, then, it would read this way. "It might be well to consider carefully the disadvantages of the tax in its present form which not only involves administrative difficulties but fails to reach large amounts of profits that it should reach."

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- Knollenberg: To get what Mr. Helvering said yesterday, I think the phrase would be better, "which involves serious administrative difficulties, and yet--"
- Sullivan: "Our proposal involves far greater administrative difficulties than the present one."
- H.M.Jr: Let's just get it down.
- Blough: Our idea in this connection was this, that you can put up with administrative difficulties if you get what you want, but why put up with administrative difficulties if you don't get what you want. Now we haven't said it, I see.
- Greenbaum: That is all right.
- Sullivan: Yes, that is it--
- Blough: The disadvantages of the tax in its present form - what was that, Carl?
- Shoup: "Which involves administrative difficulties that inevitably accompany excess profits taxation while, at the same time, failing to tax large amounts of profits that should be reached."
- Blough: Will this make everybody happy? "It might be well to consider carefully the disadvantages of the tax in its present form which involves the administrative difficulties that inevitably accompany excess profits taxation while, at the same time, failing to reach - failing to tax large amounts of profits that it should reach."
- Sullivan: That is all right.
- H.M.Jr: Is it?

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Sullivan: Yes, because by saying that it inevitably attaches to any excess profits tax, we are telling parts of the truth of the other statement. I was going to suggest putting in that if it was left the way it was in the first instance that our original proposal, while increasing the administrative difficulty, would reach those profits, but I don't think that is necessary with Roy's statement here.

H.M.Jr: Are you satisfied?

Sullivan: Yes, I am, sir.

H.M.Jr: Eddie?

Greenbaum: Yes.

H.M.Jr: Ed Foley?

Foley: Yes.

H.M.Jr: Knollenberg?

Knollenberg: Yes. Possible doubt about the syntax, but I would have to see that before I am sure.

H.M.Jr: Well, you had better take a look at it now because this is your last chance.

Knollenberg: All right.

Blough: It won't do you any good to look at it. I am afraid you can't read it.

H.M.Jr: It is past ten now.

Gaston: Instead of "but at the same time failing," make it "but at the same time fails."

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- Blough: "Which involves administrative difficulties inevitably accompanying excess profits tax, but fails to tax large amounts of profits that it should tax."
- Knollenberg: That should be "reached." There you have got a good sentence structure.
- Bell: You say, "It might be well to consider carefully the disadvantages." Do you mean that the Committee should consider? It looks as though you are going along to point them out.
- Blough: Oh, I see.
- Bell: You mean the Committee should consider?
- Greenbaum: "You should bear in mind."
- Blough: What is the suggestion, Dan?
- Bell: I was raising the question about the sentence that "it might be well to consider carefully the disadvantages," then you don't say anything about the disadvantages other than the administrative difficulties. Now, what do you mean, that the Committee should consider them or that, as - Eddie points out that the disadvantages should be borne in mind. When you read it, it looks as though you are going into the disadvantages and you don't.
- Sullivan: That is a good correction.
- Blough: "To bear in mind the disadvantages of the tax in its present form."
- Sullivan: That is right. "You should bear in mind."
- Blough: Are you willing to say, "You should bear in mind the disadvantages of the tax in its present form"?

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- Sullivan: That is right. "You should bear in mind."
- Blough: Are you willing to say, "You should bear in mind the disadvantages of the tax in its present form"?
- H.M.Jr: Or "Please bear in mind."
- Blough: "If the principles are not to be the guide for taxing corporations during the emergency period, please bear in mind--"
- Helvering: It should be "borne in mind."
- H.M.Jr: Well, anyway--
- Blough: "It would be well to bear in mind," and so forth.
- H.M.Jr: Now, look, this is the fourth time - third time I have fallen down on him on my time. A word or two here - as long as it is ninety-five percent, I said I would have it over at ten. Now, I mean, you know, one word or two doesn't - we can get another crack at it, maybe. What besides that now is there in this thing? Does that take care of the thing, Eddie, that you had in mind?
- Greenbaum: Yes, sir.
- H.M.Jr: Anything else?
- Greenbaum: The other point is this damn thing on undistributed profits tax, on the question of inflation. If you insert the word "stock dividends" on fourteen at the end of that paragraph, it would answer my point. Either through the distribution of stock dividends or some other way. I think an excellent improvement has been made in the way it is now, but it still leaves open the point of dishing out cash to individuals and it is

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purposely vague here, and I think that would make it a little more emphasis on the point we legally mean.

H.M.Jr: Are you going to limit it to stock dividends?

Greenbaum: We say, "or some other way," but I think it ought to be emphasized that you have in mind the inflationary danger of cash dividends.

Blough: You don't mean to say you wouldn't allow the credit for the cash dividends?

Greenbaum: No, but you are emphasizing the fact that you are thinking of this point, and you want also to call attention to the possibility of doing it by stock dividends. You are saying, "or in some other way."

Blough: Would you like to say "cash dividends, stock dividends, or some other way"?

Greenbaum: I would like not to mention cash dividends, because that is so obvious.

Knollenberg: The other way means that if the stockholders consent then you can tax the stockholders without any dividend at all.

Greenbaum: I would rather not have the word "stock" at all if it is coupled with cash.

Blough: Why not stop with individual income tax? "The earnings of the corporation are immediately made subject to the individual income."

Greenbaum: That would be better.

H.M.Jr: John?

Sullivan: All right.

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H.M.Jr: Roy?

Blough: It doesn't matter to me at all.

Kuhn: It is good.

H.M.Jr: All right.

Greenbaum: Nothing else.

H.M.Jr: Now, I think the best thing to do is if you would go with Miss Chauncey in her room, you see, and get that done.

## 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 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 means of this tax, but the profits of a good many business firms are not being touched by the tax,

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although those 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 imperfection 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. 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 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.

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 improvising 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

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taxing 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 met can very likely 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.

May 16, 1941  
10:14 a.m.

H.M.Jr: Hello.

Operator: Secretary Stimson.

Henry L.  
Stimson: Hello, Henry.

H.M.Jr: Good morning.

S: Good morning. I got your letter this morning on my desk. The fault of that was mine entirely. I've been thinking of it every night and then forgetting it when I got into the whirl of my office the next morning.

H.M.Jr: I see.

S: I've just called in Ayres and told him of it and I have tried to recall exactly the conversation I had with you. I should like - he will put on the envelopes that it is personal for you.

H.M.Jr: Right.

S: Now, having done that I want to say this. I went over with Ayres the details which Mr. Haas had asked for and they are - I'm going to say frankly to you - they're very much greater and involve greater labor than I had any idea of when I talked with you.

H.M.Jr: I see.

S: Ayres tells me that he has asked for the names of all of the specific manufacturers of supplies and the weapons; all of the productive schedules - production schedules not only of the finished articles but also their components; all of the actual deliveries - dates of actual deliveries; all of the unit prices and to identify all of the appropriations from which these are published.

- 2 -

- H.M.Jr: Yeah.
- S: Now, he tells me that this gives to you very much more than even the Undersecretary, who has direct charge of those things, is asking and I know myself that it is infinitely more than I ask for or get, and Ayres says that it means virtual re-duplication of our reporting and distributing system of information. Now, is there any way you can make it easier for me for I don't quite - it seems to me that unless there is some pretty vital need that you are asking it for I ought not be asked to set up a more detailed system of reporting in another Department than goes on in my own.
- H.M.Jr: You're quite right. You're quite right. Now, I tell you if we could do it this way. I don't want to ask - I mean your attitude couldn't be fairer.
- S: It is intended not only to be fair but to be generous and friendly.
- H.M.Jr: Well, it's always that. I'll tell Haas this, to confine himself to what Ayres has on hand. Hello?
- S: Yes.
- H.M.Jr: If it doesn't fall in, give me a 5 or 10% leeway. Is that all right? I mean, if there is some little special thing that he might want because he thinks he might need it, but I'll tell him to try his best to confine himself to what Ayres has on hand.
- S: Yes. Well, of course, Ayres has stuck away in the records everything that you want, but he hasn't got the machinery for distributing it regularly. That's the point that I'm mentioning.
- H.M.Jr: Well, may I do this. I'll tell Haas to go over and see Ayres and see if we can't

- 3 -

have what I want so that we can tell how much money is going to be spent a month, you see?

S: Yes.

H.M.Jr: I mean, how rapidly this money is going to be spent so we can make our estimates.

S: Can you give me on the phone just the general purpose you have in mind so that I can have a fairer .....

H.M.Jr: The general purpose is this. We've made an estimate that the defense money is going to amount to \$19 billion during the fiscal year beginning July 1.

S: Yes, that is \$9 billion .....

H.M.Jr: \$19 billion - no, wait a minute - I'm wrong. A billion a month, an average of a billion a month - a total of \$19.

S: Average 1 billion a month.

H.M.Jr: See?

S: Yes.

H.M.Jr: Now.....

S: During the fiscal year '41.

H.M.Jr: Yes. Now, what I'm trying to do is - then you see we set up our whole tax bill on the basis of that. You see?

S: Yes, I see.

H.M.Jr: And our borrowing. Now, what I want to have is as accurate as possible - that's why we want to go back. Is this stuff going to come off faster or slower. See?

S: I see.

- 4 -

- HMJr: How near right are we in our estimate that the total defense expenditures beginning July 1, are going to average a billion a month?
- S: Yes. The - you mean the expenditures will probably correspond to the deliveries.
- HMJr: Yes, yes.
- S: I see.
- HMJr: Now that certainly - that's something I ought to have in order to make my estimate for borrowing and our estimate for the tax bill.
- S: Yes, I see. I see. Well, I should think that could be gotten for you without going into quite so much detail. Ayers said that Haas had asked for it.
- HMJr: Well...
- S: I mean the specific names of the specific manufacturers.
- HMJr: Well, if you will talk with Ayers, I'll send Haas over and tell him to go over the thing once more, see?
- S: Yes. All right.
- HMJr: Did that - now does this request I'm making now sound reasonable?
- S: Why yes. I want to - in other words you know I'm most anxious to make your duty as Secretary of the Treasury easy because as a citizen, even not a Secretary of War, I'm interested in that, and I'll try to do my best to make it so.
- HMJr: You see, Harry, we have estimated total expenditures at nineteen. The Bureau of the Budget says its going to be twenty-one or twenty-two and OPM says its twenty-four.
- S: Yes, I see. You estimate a total of nineteen.

- 5 -

HMJr: Yes.

S: OPM, twenty-four.

HMJr: Yeah.

S: And what the Budget.....

HMJr: And Budget said they'd split the difference.

S: Yes. Budget then about....

HMJr: Twenty-one or two.

S: Twenty-one or two. I see. I think you are entitled to that.

HMJr: Not too big a difference.

S: Yes, I see. All right.

HMJr: Thank you.

S: Good-bye.

May 16, 1941  
11:25 a.m.

HMJr: Hello.

Grace  
Tully: Hello, Henry?

HMJr: Good morning.

T: Good morning. I gave that memorandum  
to the President....

HMJr: Yes.

T: And he said to tell you that he  
would not be able to read that  
statement until late this afternoon,  
anyway. He's full of appointments.

HMJr: Yeah.

T: And that he'd telephone you and if  
you wanted to go to the country,  
he'd call you there or call anybody  
you suggest in your department.

HMJr: No, I think - I rather just sit here  
until he does.

T: I see.

HMJr: See?

T: All right. I'll tell him, Henry.

HMJr: Now, I think that - don't you think  
so?

T: Well, now - I don't know what it  
requires.

HMJr: Well, it's a .....

T: I think probably it would be more  
satisfactory.

- 2 -

HMJr: I think so, if he can - if he could - you think there's a chance of getting to it today?

T: Well, he said he'd do his best to get to it late this afternoon.

HMJr: Well, you tell him that I'm just going to sit until he's ready and if he can let me know as soon as possible, I'd appreciate it.

T: All right, I know he will, Henry.

HMJr: And if you could remind him, I'd appreciate it.

T: I certainly will.

HMJr: Thank you.

T: Fine. Good-bye.

THE SECRETARY OF THE TREASURY  
WASHINGTON

May 16, 1941

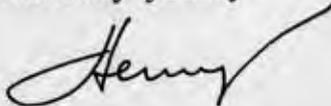
My dear Mr. President:

I am inclosing herewith the proposed statement which John Sullivan will present to the Ways and Means Committee on Monday. I would very much appreciate your comment and suggestions so that when John Sullivan goes before the Committee on Monday he can say that the statement he is presenting meets with your entire approval.

I am also inclosing herewith a copy of the statement which we gave you on July 8, 1940.

I would greatly appreciate it if you could get word to me by one o'clock today whether or not this statement has your approval, or whether you would like to work on it with me over the week-end. If it is unnecessary to work on it this week-end, I would like to go to the farm.

Sincerely yours,



The President,  
The White House.

Enclosures.

July 8, 1940

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 excess-profits principle, adopted in our 1918 Act, which taxes profits above a stated percentage of invested capital, 8% in our 1918 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 excess-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

- 4 -

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.

## 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

- 2 -

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 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 means of this tax, but the profits of a good many business firms are not being touched by the tax,

- 3 -

although those 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

- 4 -

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,

- 5 -

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

- 6 -

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 <sup>expectations</sup> ~~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 which is now to be subjected to a much heavier 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.

- 7 -

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. <sup>¶</sup>The law, however, has not achieved that objective. <sup>¶</sup>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

- 8 -

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.

### 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

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 company which received over \$250 million of defense contracts 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 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.]

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

4%?

to increase?

suggests  
 no new  
 revenue  
 necessary  
 here

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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 improvising such a base on short notice at a later date.

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.

#### IV. Possible alternative

If these principles are not to be the guide for

taxing corporations during the emergency period, it would be well to bear in mind the disadvantages of the tax in its present form, which involves the administrative difficulties inevitably accompanying excess profits taxation but fails to tax large amounts of profits that should be reached. 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.

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 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.

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.

*Emphasize Consumer Durable Goods  
Tax ahead of " Non " " Tax*

*No rates or yield*

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- 8 -

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.

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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.

- 9 -

### 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

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 company which received over \$250 million of defense contracts 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 \$500,000 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

- 12 -

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.

*explain  
scale*

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. 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 improvising such a base on short notice at a later date.

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.

IV. Possible alternative

If these principles are not to be the guide for

taxing corporations during the emergency period, it would be well to bear in mind the disadvantages of the tax in its present form, which involves the administrative difficulties inevitably accompanying excess profits taxation but fails to tax large amounts of profits that should be reached. 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.

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 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.

I do not set forth this plan as one that carries

- 15 -

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.

July 8, 1940

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 excess-profits principle, adopted in our 1918 Act, which taxes profits above a stated percentage of invested capital, 8% in our 1918 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 excess-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 1916 Act scheme of 3 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

- 4 -

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.

Note: This memo prepared by Sullivan, Magill and Randolph Paul and submitted to the President at 12:20 conference, 7/8'40

May 16, 1941  
11:40 a.m.

Eugene  
Duffield:

Hello.

HMJr:

How are you, Gene?

D:

Very well. How are you, sir?

HMJr:

Oh, alive, anyway.

D:

Well, I'm sorry if you are not  
so well.

HMJr:

Gene, no. I'm all right. Just a  
little overworked, which is chronic.  
You may or may not want to answer  
this over the phone or in person  
or not at all.....

D:

Yeah.

HMJr:

Bryant's story this morning on the  
split in the Treasury.... I just  
wanted to know whether it was a  
leak in the Treasury or whether it  
came off the Hill.

D:

It came off the Hill.

HMJr:

Well, that's all I wanted.....

D:

Very definitely.

HMJr:

Yeah.

D:

That's absolutely true. He spent  
all of his time up there recently  
and he came in with it from the  
Hill yesterday.

HMJr:

I see.

D:

I know specifically where he got  
it on the Hill because I was very  
careful to find out, but if you  
don't mind, I'd rather not say that.

HMJr:

I wont press you.

May 16, 1941  
11:40 a.m.

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it on the Hill because I was very  
careful to find out, but if you  
don't mind, I'd rather not say that.

HMJr:

I wont press you.

- 2 -

D: Yeah. But, it did come from there.

HMJr: You mean it would be embarrassing?

D: Yeah, I'm afraid so.

HMJr: Well, sometime.....

D: I mean you got to work with the fellow...(laughs)

HMJr: I know, well - could I make one guess?

D: (Laughs) Well, one.

HMJr: One?

D: I'll allow one.

HMJr: You let me have one?

D: Yeah.

HMJr: All right, just one and (laughs)  
I wont cheat.

D: Yeah.

HMJr: Dan.

D: Uh huh. (laughs) Yeah.

HMJr: And I give you my word I wont repeat it to anybody in the Treasury.

D: I wish you wouldn't.

HMJr: Upon my word of honor

D: Okay, sir.

HMJr: My word of honor.

D: That satisfies me, you know that.

HMJr: I wont - nobody will know it.

D: Okay. Good-bye.

- 3 -

HMJr: But, I've been suspicious of that so-and-so for a long time.

D: Yeah.

HMJr: It just helps me, but nobody is going to know it, Gene.

D: Okay, fine.

HMJr: My word of honor.

D: Fine

HMJr: Thank you.

D: You bet.

HMJr: Hello.

D: Yeah.

HMJr: Well, there's nothing

D: Some time when you are not very busy - I don't know when that will ever be - I'd like five minutes.

HMJr: Well, there will be no time as good as this afternoon because I have no appointments because I thought I was going away and I am not and I have no Cabinet.

D: I see.

HMJr: So if you care to come in at two-thirty.

D: All right, I'll be there.

HMJr: Okay.

D: Fine.

HMJr: Good-bye.

May 16, 1941.

Dear Mr. Secretary:

Supplementing my acknowledgment of April 21, further reference is made to your letter of April 15, in which you suggested the desirability of organizing a patrol force, to operate under the Treasury Department, for the better protection of ship repair and manufacturing plants performing Navy contracts and located upon waterfront property in the various United States ports.

Your suggestion has been very carefully considered and we are now engaged in taking steps to put it into effect. Some 270 power craft of the Coast Guard Auxiliary are to be called into active service and the patrol of waterfront industrial property in the important harbors of the United States will be greatly increased and intensified. Special attention will be given to the protection of those establishments which are engaged in the performance of Navy contracts.

It will be appreciated if you will cause to be issued to the various Commandants of Naval Districts instructions to provide Captains of Ports, on request, information as to establishments in their areas having Naval contracts.

Sincerely yours,

(Signed) Herbert E. Gaston

Acting Secretary of the Treasury.

The Honorable

The Secretary of the Navy.

cc: sent to Admiral Warrick 5-16-41  
cc: Miss Chauncey ✓

April 21, 1941.

Dear Mr. Secretary:

This is to acknowledge receipt of your letter of April 15th, in which you suggest the desirability of organizing a patrol force, to operate under the Treasury Department, for the better protection of ship repair and manufacturing plants performing Navy contracts and located upon waterfront property in the various United States ports.

I shall be glad to give this matter study and will report my conclusions at an early date.

Sincerely yours,

Secretary of the Treasury.

The Honorable

The Secretary of the Navy.

(MC)4-2  
Ser. 0109116

THE SECRETARY OF THE NAVY  
WASHINGTON

CONFIDENTIAL.

April 15, 1941.

My dear Mr. Secretary:

The possibility of the sabotage of ship repair and manufacturing plants performing Navy contracts and located upon waterfront property in the various United States ports is a matter of grave concern to this department. The prevention of such sabotage is rendered particularly difficult because of the ease with which the saboteurs may gain access to such plants by small boats under cover of darkness. The problem presented is of course closely related to the general problem of the protection of shipping in our harbors from sabotage.

Some measure of protection is now afforded by the local Coast Guard harbor patrol units, by local police patrol boats and by the local police patrol along the inshore end of docks and plants. Also in the case of vessels engaged in foreign trade, which may be lying at the docks, some protection is given by the presence of U. S. Customs inspectors on board the vessels or upon the docks. However, as a practical matter the patrol carried on by the Coast Guard and police boats is of an infrequent nature and mostly off the ends of the piers, while the waterfront police confine their efforts largely to the gates and entrances to the piers. The guarding of the slips in between the piers, where the saboteurs will operate in most cases, does not appear to be effective.

The Coast Guard with its present force in New York is able to patrol part of the waterfront only once daily and the balance not over two or three times daily. Obviously, the extent of this patrol is not sufficient to make it an effective defense against sabotage. It is probable that the same ineffective patrol exists in our other large ports.

In view of the foregoing, I desire to bring to your attention the advisability of organizing in each of our harbors, where sabotage may be expected to take place, a patrol force operating under the Treasury Department of sufficient size and

- 2 -

strength to effectively cope with this problem. This department will be glad to advise you upon request as to the names and location of the ship yards and plants employed on Navy contracts which it considers should receive this waterfront protection.

Sincerely yours,

(Signed) Frank Knox

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

## TREASURY DEPARTMENT

## INTER-OFFICE COMMUNICATION

DATE May 16, 1941

TO Secretary Morgenthau  
FROM Mr. Cochran

## STRICTLY CONFIDENTIAL

At 2:55 yesterday afternoon Mr. Ray Atherton, Acting Chief of the European Division, telephoned me from the Department of State. He said he had just stepped out of Secretary Hull's office to try to get a message to Assistant Secretary of Treasury Gaston, but had not been able to reach him. Atherton asked, therefore, that I try to communicate to Mr. Gaston, at the earliest possible moment, a message to the effect that Secretary Hull feels that a guard should be placed on all French ships in our ports immediately.

Upon receiving this message I went at once to Mr. Gaston's office and learned that he was with the Secretary. Consequently I went to the Secretary's office and informed the Secretary, as well as Mr. Gaston, of Mr. Hull's message. The Secretary asked Mr. Gaston to put the machinery into effect at once for carrying out this request. Mr. Atherton called me back later in the afternoon and I confirmed that I had delivered the message immediately after its receipt by me, and that steps had been taken at once to place the guards.



MAY 16 1941

Dear Mr. Aldrich:

I have your letter of May 12, 1941, enclosing a memorandum outlining the nature and scope of certain transactions which your bank is carrying on with German, Italian, and Japanese banks and firms, and advising me that you would be glad to be guided by the wishes of the Treasury either now or at any time in the future, if in my opinion it should be inadvisable for your bank to continue to furnish any of these facilities.

I appreciate very much your bringing this matter to my attention. I have it under study and will be glad to advise you in case we want to take advantage of your kind offer.

Sincerely yours,

(Signed) H. Morgenthau, Jr.

Secretary of the Treasury

Mr. Winthrop W. Aldrich,  
Chairman,  
Board of Directors,  
The Chase National Bank,  
New York City.

File to D.W. Bell  
Copy to Mr. Cochran  
" " " Thompson  
" " NMC

DWB:nlc:ec  
5-15-41



# The Chase National Bank

OF THE CITY OF NEW YORK

New York

May 12, 1941

WINTROP W ALDRICH  
CHAIRMAN BOARD OF DIRECTORS

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

*Hull*

Dear Mr. Secretary:

Those of us who are responsible for conducting the policy of this Bank recognize that during the present period of international tension it is extremely important that American banks should cooperate in every possible way with the Administration.

On the other hand, it is difficult, in the absence of action by the United States Government to control assets owned by German, Italian and Japanese nationals, for us to refuse to continue to handle for the benefit of our American customers and depositors such ordinary business as they may have in Central Europe, Italy and Japan, or to refuse to continue our correspondent relations with German, Italian and Japanese banks and firms.

The nature and scope of the transactions which I have in mind are outlined in the enclosed memorandum. I have no reason to suppose that any of these transactions is in any way contrary to the policy which the Administration would wish to have us follow, but with the thought in mind that it might not have occurred to you that some of these transactions were being carried on, I have felt it desirable to call them to your attention.

I am sure that it is not necessary for me to tell you that if, in your opinion, it should be inadvisable for us to continue to furnish any of these facilities, we will be glad to be guided by your wishes either now or at any time in the future.

Very sincerely yours,

*Wintrop W. Aldrich*  
Chairman Board of Directors.

Enclosure.

I - GERMANY

- A) - We continue to carry current accounts in the names of German banks and firms and effect payments and collections on their behalf, including all the routine banking transactions involved in an ordinary correspondent relationship.
- B) - Ever since the German crisis of 1931, we have been actively engaged in the liquidation of credits extended by this and other American banks in Germany. Under the Standstill Agreements concluded with the German banks, the American banks had the right to require debtors to settle their debts in German Marks. These Marks were and are still being sold to buyers in the United States and elsewhere and are generally used for support of families, charitable contributions and travel.
- C) - Prominent American concerns doing business in Germany are using our services in connection with the transfer to the United States, after conversion, of interest, dividends, royalties collected in Marks in Germany.
- D) - We have been instrumental in liquidating funds inherited by United States citizens or residents in Germany.
- E) - We have received from German residents of the United States desirous of returning to Germany to take up permanent residence there, dollars which were credited to the account of the Deutsche Goldkreditbank for the purpose of conversion into Marks to be paid to these emigrants upon their arrival in Germany.

The gross volume of all transactions completed during the first four months of 1941 amounted to slightly under \$4,300,000.

II - ITALY

- A) - We continue to carry current accounts in the names of Italian banks and firms and effect payments and collections on their behalf, including all the routine banking transactions involved in an ordinary correspondent relationship.
- B) - Prominent American concerns doing business in Italy are using our services in connection with the transfer to the United States, after conversion, of interest, dividends, royalties collected in Liras in Italy.
- C) - For American investors, holders of Italian shares and dollar bonds in default, we have been instrumental in the sale and disposal thereof in Italy.
- D) - We have made and are making remittances representing gifts, support of families and charitable contributions, mainly for account of Italian residents in the United States and for the Catholic Church. Considerable payments of this kind have been made to the Vatican, the Society of Jesus and various missionary societies in Italy. Other sales are made mainly to steamship companies, passenger, travel and freight agencies and American and Italian banks.

May 12, 1941

-2-

II - ITALY continued

- E) - We are transferring funds to subsidiaries and agents of American firms in Italy and to the Italian Offices of the American Press.

The gross volume of all transactions completed during the first four months of 1941 amounted to slightly under \$1,900,000.

III - JAPAN

- A) - We continue to carry current accounts in the names of Japanese banks and firms, most of whom are established in New York, and effect payments and collections on their behalf including all the routine transactions involved in an ordinary correspondent relationship, such as opening of commercial credits on a fully secured basis to finance the importation of silk and rubber, loans against goods in warehouse (stored in this country), loans against U. S. Government Bonds, discount of trade acceptances and purchase and sale of foreign exchange.

The gross volume of such transactions on our books at the present time amounts to about \$6,100,000.

May 16, 1941

CONFIDENTIAL

Dear Mr. Knabe:

I have pleasure in acknowledging, on behalf of Secretary Morgenthau, the receipt of your letter of May 15, 1941, enclosing your compilation for the week ended May 7, 1941, showing dollar disbursements out of the British Empire and French accounts at the Federal Reserve Bank of New York, and the means by which these expenditures were financed.

Faithfully yours,



H. Marie Cochran  
Technical Assistant to the Secretary

L. W. Knabe, Esquire,  
Vice President,  
Federal Reserve Bank of New York,  
New York, New York.

HMC:lap-5/16/41

F. P. B. Dallas Disbursements

C  
O  
P  
YFEDERAL RESERVE BANK  
OF NEW YORK

May 15, 1941.

CONFIDENTIALDear Mr. Secretary: Attention: Mr. H. Merle Cochran

I am enclosing our compilation for the week ended May 7, 1941, showing dollar disbursements out of the British Empire and French accounts at this bank and the means by which these expenditures were financed.

Faithfully yours,

/s/ L. W. Knoke

L. W. Knoke,  
Vice President.

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

Enclosures

COPY:mg:5/16/41

**ANALYSIS OF BRITISH AND FRENCH ACCOUNTS**  
(In Millions of Dollars)

Week Ended May 7, 1941.

Strictly  
Confidential

PERIOD	Bank of England (BRITISH GOVERNMENT)							BANK OF FRANCE						Net Incr. (+) or Debr. (-) in Balance	
	DEBITS			CREDITS				DEBITS			CREDITS				
	Total Debits	Gov't Expenditures (a)	Other Debits	Total Credits	Proceeds of Sales of Gold	Securities Official (b)	Other Credits (c)	Total Debits	Gov't Expenditures (d)	Other Debits	Total Credits	Proceeds of Sales	Other Credits		
First year of war (8/29/39-8/28/40)*	1,793.2	605.6	1,187.6	1,928.2	1,356.1	52.0	420.1	+ 35.0	866.3 (e)	416.6 (e)	449.7	1,095.3 (e)	900.2	195.1 (e)	-289.0
1940															
Aug. 29 - Oct. 2	516.8	244.9	271.9	208.9	271.5	6.0	31.4	- 7.9	5.6	4.4	4.2	1.3	-	1.3	- 7.3
Oct. 3 - 30	196.7	167.8	28.9	198.5	160.5	6.0	32.0	+ 1.8	0.5	0.3	0.2	0.5	-	0.5	-
Oct. 31 - Nov. 27	241.0	201.1	39.9	259.5	210.0	18.0	31.5	+ 18.5	0.8	0.1	0.7	0.7	-	0.7	- 0.1
Nov. 28 - Dec. 31	234.6	206.8	27.8	198.0	111.4	26.0	60.6	- 36.6	2.1	-	2.1	0.6	-	0.6	- 1.5
War period through Dec. 31, 1940	2,788.2	1,425.6	1,362.7	2,793.1	2,109.5	108.0	575.6	+ 10.8	878.3	421.4	456.9	1,098.4	900.2	198.2	+220.1
1941															
Jan. 2 - 29	197.4	182.7	34.7	259.9	176.2	52.0	31.7	+ 62.5	1.7	-	1.7	0.5	-	0.5	- 1.2
Jan. 30 - Feb. 26	164.6	137.8	26.8	101.4	26.6	26.0	48.8	- 63.2	0.2	-	0.2	0.2	-	0.2	-
Feb. 27 - Apr. 2	229.7	157.6	32.1	237.9	105.7	72.0	62.2	+ 8.2	0.7	-	0.7	1.6	-	1.6	+ 0.9
Apr. 3 - Apr. 30	126.0	101.9	24.1	218.9	125.6	15.0	78.3	+92.9	0.9	-	0.9	0.9	-	0.9	-
May 1 - May 28															
May 29 - July 2															
July 3 - July 30															
July 31 - Aug. 27															
Second year of war (8/29/40-8/27/41)															
Aug. 28 - Oct. 1															
Oct. 2 - Oct. 29															
Oct. 30 - Dec. 3															
Dec. 4 - 31															
WEEK ENDED:															
April 16	29.2	23.8	5.4	49.0	-	2.0	47.0	+19.8	0.5	-	0.5	0.4	-	0.4	- 0.1
23	37.2	32.6	4.6	16.5	-	3.0	13.5	-20.7	0.3	-	0.3	0.1	-	0.1	- 0.2
30	27.0	20.7	6.3	15.1	-	4.0	11.1	-11.9	-	-	-	0.3	-	0.3	+ 0.3
May 7	39.6	29.2	10.4 (f)	17.1	-	6.0	11.1 (g)	-23.5	0.2	-	0.2	0.2	-	0.2	-

Average Weekly Expenditures Since Outbreak of War  
France (through June 19) \$19.6 million

England (through June 19) 27.6 million  
England (since June 19) 51.7 million

Transfers from British Purchasing Commission to  
Bank of Canada for French Account

Week ended May 7 \$ 0.5 million  
Cumulation from July 6 \$162.7 million

(See footnotes on reverse side)

\* For monthly breakdown see tabulations prior to April 23, 1941.

- (a) Includes payments for account of British Purchasing Commission, British Air Ministry, British Supply Board, Ministry of Supply, Timber Control, and Ministry of Shipping.
- (b) Estimated figures based on transfers from the New York Agency of the Bank of Montreal, which apparently received the proceeds of official British sales of American securities, including those effected through direct negotiation. In addition to the official selling, substantial liquidation of securities for private British account occurred, particularly during the early months of the war, although the receipt of the proceeds at this Bank cannot be identified with any accuracy. According to data supplied by the British Treasury and released by Secretary Morgenthau, total official and private British liquidation of our securities through December, 1940 amounted to \$334 million.
- (c) Includes about \$85 million received during October, 1939 from the accounts of British authorized banks with New York banks, presumably reflecting the requisitioning of private dollar balances. Other large transfers from such accounts since October, 1939 apparently represent the acquisition of proceeds of exports from the sterling area and other currently accruing dollar receipts.
- (d) Includes payments for account of French Air Commission and French Purchasing Commission.
- (e) Adjusted to eliminate the effect of \$30 million paid out on June 26, 1940 and returned the following day.
- (f) Includes about \$4.4 million transferred to De Javasche Bank account here.
- (g) Includes about \$3.9 million representing the proceeds of wool exports to U. S.

UNITED STATES AND AUSTRALIAN ACCOUNTS  
 (Continued)

New York, May 1, 1941.

Strictly  
 Confidential

PERIOD	Total Debits	Transfers to Official British A/C	Other Debits	Total Credits	Proceeds of Gold Sales	Transfers from Official British A/C		Other Credits	Net Disc. (+) or Decr. (-) in Balance	Total Debits	Official British A/C	Other Debits	Other Credits	Total Sales	Total Credits	Net Disc. (+) or Decr. (-) in Balance
						For Own A/C	For French A/C									
First year of war (8/29/39-8/28/40)*	323.0	16.6	306.4	504.7	412.7	20.9	36.7	32.4	+181.7	31.2	3.9	27.3	36.1	30.0	6.1	+ 4.9
1940																
Aug. 29 - Oct. 2	44.3	-	44.3	43.9	15.4	-	27.3	0.2	- 0.4	8.7	2.5	6.2	8.0	6.7	1.3	- 0.7
Oct. 3 - 30	26.7	-	26.7	28.6	14.0	-	14.3	0.3	+ 1.9	10.1	7.5	2.6	7.9	6.5	1.4	- 2.2
Oct. 31 - Nov. 27	35.2	-	35.2	69.6	49.2	-	16.7	3.7	+ 34.4	3.1	0.6	2.5	3.6	2.1	1.5	+ 0.5
Nov. 28 - Dec. 31	48.0	-	48.0	60.6	42.5	-	13.7	4.4	+ 12.6	4.8	-	4.8	6.8	4.8	2.0	+ 2.0
War period through Dec.	477.2	16.6	460.6	707.4	534.8	20.9	110.7	41.0	+230.8	57.9	14.5	43.4	62.4	50.1	12.3	+ 4.5
1941																
Jan. 2 - 29	33.7	-	33.7	33.9	16.9	-	15.0	2.0	+ 0.2	4.8	-	4.8	6.8	5.1	1.7	+ 2.0
Jan. 30 - Feb. 26	31.1	-	31.1	24.3	14.3	-	6.8	3.2	- 6.8	5.0	1.7	3.3	3.2	0.6	2.6	- 1.8
Feb. 27 - Apr. 2	60.9	-	60.9	46.0	23.1	-	19.1	3.8	- 14.9	5.8	0.8	5.0	15.7	12.5	1.2	+ 7.9
Apr. 3 - Apr. 30	34.9	-	34.9	35.9	12.5	-	10.5	12.9	+ 1.0	2.8	-	2.8	5.9	4.6	1.3	+ 3.1
May 1 - May 28																
May 29 - July 2																
July 3 - July 30																
July 31 - Aug. 27																
Second year of war (8/29/40-8/27/41)																
Aug. 28 - Oct. 1																
Oct. 2 - Oct. 29																
Oct. 30 - Dec. 3																
Dec. 4 - 31																
WEEK ENDED:																
April 16	4.0	-	4.0	7.5	3.6	-	-	1.9	+ 3.5	0.2	-	0.2	-	-	-	- 0.2
23	11.7	-	11.7	17.9	2.0	-	10.0	1.9	+ 2.2	0.3	-	0.3	4.6	4.4	0.2	+ 4.3
30	16.9	-	16.9	8.0	6.8	-	-	1.2	- 8.9	1.1	-	1.1	0.7	0.2	0.5	- 0.4
May 7	9.0	-	9.0	12.2	3.5	-	0.5	8.2	+ 3.2	1.7	-	1.7	0.1	-	0.1	- 1.6

Weekly Average of Total Debits Since Outbreak of War

Through May 7 \$ 7.4 million

\* For monthly breakdown see tabulations prior to April 23, 1941.

TREASURY DEPARTMENT

FOR RELEASE, MORNING PAPERS  
Friday, May 16, 1941

The Secretary of the Treasury, by this public notice, invites tenders for \$100,000,000, or thereabouts, of 91-day Treasury bills, to be issued on a discount basis under competitive bidding. The bills of this series will be dated May 21, 1941, and will mature August 20, 1941, when the face amount will be payable without interest. They will be issued in bearer form only, and in denominations of \$1,000, \$5,000, \$10,000, \$100,000, \$500,000, and \$1,000,000 (maturity value).

Tenders will be received at Federal Reserve Banks and Branches up to the closing hour, two o'clock p. m., Eastern Standard time, Monday, May 19, 1941. Tenders will not be received at the Treasury Department, Washington. Each tender must be for an even multiple of \$1,000, and the price offered must be expressed on the basis of 100, with not more than three decimals, e. g., 99.925. Fractions may not be used. It is urged that tenders be made on the printed forms and forwarded in the special envelopes which will be supplied by Federal Reserve Banks or Branches on application therefor.

Tenders will be received without deposit from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. Tenders from others must be accompanied by payment of 10 percent of the face amount of Treasury bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

Immediately after the closing hour, tenders will be opened at the

- 2 -

Federal Reserve Banks and Branches, following which public announcement will be made by the Secretary of the Treasury of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection thereof. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and his action in any such respect shall be final. Payment of accepted tenders at the prices offered must be made or completed at the Federal Reserve Bank in cash or other immediately available funds on May 21, 1941.

The income derived from Treasury bills, whether interest or gain from the sale or other disposition of the bills, shall not have any exemption, as such, and loss from the sale or other disposition of Treasury bills shall not have any special treatment, as such, under Federal tax Acts now or hereafter enacted. The bills shall be subject to estate, inheritance, gift, or other excise taxes, whether Federal or State, but shall be exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority. For purposes of taxation the amount of discount at which Treasury bills are originally sold by the United States shall be considered to be interest.

Treasury Department Circular No. 418, as amended, and this notice, prescribe the terms of the Treasury bills and govern the conditions of their issue. Copies of the circular may be obtained from any Federal Reserve Bank or Branch.

- oOo -

Fifty Largest Bank and Insurance  
Company Holders of the 3-1/4's of 1941  
(In millions of dollars)

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Name	March 31	April 30	Net change
1. Guaranty Trust Co. of New York	58.0	57.9	-.1
2. The Travelers Insurance Co. of Hartford	40.0	40.0	
3. First National Bank, Baltimore	35.0	30.0	-5.0
4. National City Bank, New York	25.0	25.0	
5. Bank of New York	23.4	12.8	-10.6
6. National Bank of Detroit	21.7	21.7	
7. Equitable Life Assurance Society of U.S., New York	20.7	20.7	
8. Central Hanover Bank and Trust Co., New York	14.0	14.0	
9. Metropolitan Life Insurance Co., New York	12.5	12.5	
10. Union Trust Co. of Pittsburgh, Pa.	12.4	12.4	
11. Bank for Savings in the City of New York	10.0	10.0	
12. American Trust Co., San Francisco	9.0	5.0	-4.0
13. The Prudential Insurance Co. of America, Newark	8.0	8.0	
14. Savings Banks Trust Co., New York	8.0	5.0	-3.0
15. New York Trust Company	7.6	7.6	
16. Mutual Life Insurance Co. of New York	7.5	7.5	
17. Troy Savings Bank, Troy, New York	6.0	6.0	
18. Chemical Bank & Trust Co., New York	5.1	-	-5.1
19. Penn Mutual Life Insurance Co., Philadelphia	5.0	5.0	
20. Provident Mutual Life Insurance Co., Philadelphia	5.0	5.0	
21. Bank of the Manhattan Co., New York	5.0	5.0	
22. First National Bank, New York	5.0	4.0	-1.0
23. National City Bank, Cleveland	4.3	4.3	
24. Wilmington Trust Co., Wilmington	4.2	4.2	
25. Toledo Trust Co., Toledo	4.1	4.1	
26. American Mutual Liability Insurance Co., Boston	4.0	4.0	
27. First National Bank, Palm Beach, Florida	4.0	4.0	
28. Baltimore National Bank, Baltimore	3.5	3.5	
29. Bankers Trust Co., New York	3.5	3.1	-.4
30. North River Savings Bank, New York	3.5	3.5	
31. Mellon National Bank, Pittsburgh, Pa.	3.3	3.3	
32. Lawyers Trust Co., New York	3.0	3.0	
33. City Trust & Savings Bank, Youngstown, Ohio	3.0	3.9	+ .9
34. John Hancock Life Insurance Co., Boston	3.0	3.0	
35. First National Bank, Boston	3.0	3.0	
36. Strafford Savings Bank, Dover, N. H.	2.7	2.7	
37. Empire Trust Co., New York	2.7	2.7	
38. Franklin Savings Bank in the City of New York	2.7	2.7	
39. Greenwich Savings Bank, New York	2.6	2.6	
40. Liberty Bank of Buffalo	2.5	2.5	
41. Union Dime Savings Bank, New York	2.5	2.5	
42. United States Trust Co. of New York	2.5	2.5	
43. Flatbush Savings Bank, Brooklyn	2.5	2.5	
44. American Automobile Insurance Co., St. Louis, Mo.	2.5	2.5	
45. National Fire Insurance Co. of Hartford	2.5	2.5	
46. The Merrill Trust Co., Bangor, Maine	2.4	2.4	
47. Brown Brothers Harriman & Co., New York	2.4	-	-2.4
48. Washington Mutual Savings Bank, Seattle	2.3	2.3	
49. First National Bank, Lincoln, Nebraska	2.2	4.3	+2.1
50. East New York Savings Bank, Brooklyn	2.1	2.1	
Total	427.4	398.8	-28.6

TREASURY DEPARTMENT

INTER-OFFICE COMMUNICATION

DATE May 16, 1941

TO  
FROM

*Given me by Bell  
May 20<sup>th</sup> 1941*

Tax Anticipation Certificates

The following discount tax certificates are proposed to be offered for those who wish to voluntarily make provision for their income taxes in advance.

It is suggested that there should be a certificate for each tax date, that is, four series a year -- March, June, September and December. The purchase price should be progressively increased as the time to maturity becomes shorter, thus making the certificate a discount security. Discount rates would be worked out on the basis of a \$100 unit of 12 months maturity selling for \$99.40, with the price increasing 5¢ each month as shown in the accompanying tables. These securities would be offered in \$25, \$50, \$100, \$500, \$1000 and \$5000 units.

It is proposed:

- (1) That not more than \$5000 of these tax certificates could be turned in in payment of taxes at any given quarterly tax date.
- (2) That the name of the purchaser and date of purchase should be entered on the certificate at the time of purchase. They would not be transferable.
- (3) That these certificates will be accepted at par only in payment of income taxes if tendered by the purchaser on or after the maturity date.
- (4) That the original purchaser may redeem his certificates at the original purchase price at any time.
- (5) That these certificates be sold only at the twelve Federal Reserve Banks and their branches.
- (6) That for smaller units than \$25, existing Postal Savings stamps could be purchased in anticipation and turned in in payment of taxes.

DEFENSE SAVINGS STAFF  
ADVANCE NOTICE RADIO PROGRAMS

FRIDAY, MAY 16

Time: 2:00 - 2:15 P.M.

Station: WRC, Washington, D. C., and National  
Broadcasting Company Red Network.

Program: Proctor & Gamble's "Against the Storm".  
(Closing plug immediately following  
show)

Time: 10:45 - 11:00 P.M.

Station: WRC, Washington, D. C., and National  
Broadcasting Company Red Network.

Program: Ignace Jan Paderewski "Buy A Share  
In America".

THESE PROGRAMS PROMOTE SALE OF DEFENSE BONDS AND STAMPS

FAMOUS STAR PROMOTES DEFENSE BONDS SALE

Here is an example of how noted stars of stage, radio and screen are getting behind the sale of Defense Bonds and Stamps to the nation.

Stepping out of her customary role of comedian, Miss Ilka Chase broadcast the following statement over a coast to coast national broadcasting network last Saturday afternoon, May 10th on her "Luncheon at the Waldorf" broadcast:

"It seems to me that the time has come when Americans must take stock. We must stand fast for what we believe in. Nobody asks to be born into the generation that has to do the fighting. It is much more convenient to find alibis than to go to bat for your beliefs. But let us not slip into the fatal lethargy which believes that liberty is something won at Valley Forge and automatically ours for all time.

"Liberty, my friends, is almost as perishable as love. We must be constant and alert in our guardianship of it and we must be realistic, I think, in our contribution towards its maintenance. It may be that with infinite good luck and shrewdness and unflagging effort we will still be able to avoid actual combat. But we must have an impregnable defense and if by giving only our money we can assure that, it seems to me the price is very small.

"And remember, in this country there is no high-handed appropriation of personal funds. Instead, our Government is giving every one of us the opportunity to participate in as sound an investment as there is in the country today. Not only is it our privilege--it is to our individual advantage to buy as many Defense Savings Bonds as we can afford. Believe me, it is frightfully important. Let's all go to our bank or nearest post office and purchase what we can, either stamps or bonds in whatever denomination fits our pockets. All of us who do this are making money, which is indeed a rosy prospect, but what under the circumstances, is perhaps even more heart-warming, is that we are contributing to our present security and to that better future which must ever be the goal of all free peoples."

Such statements by stars whose followers number millions are most convincing to huge masses of Americans. We are gratified indeed to find their cooperation so wholehearted and sincere.

Vincent F. Callahan,  
Chief, Radio Section

## 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
15	16,984	4,255	1,952	10,777	1,116	15,867	3,139	1,952	10,777	91
Total	\$231,775	\$ 48,703	\$ 26,246	\$156,825	\$ 18,760	\$213,015	\$ 29,944	\$ 26,246	\$156,825	\$ 2,144

May 16, 1941.

Treasury Department, Division of Research and Statistics.

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.

## TREASURY DEPARTMENT

## INTER OFFICE COMMUNICATION

DATE May 16, 1941

TO Secretary Morgenthau  
FROM Helen Dallas

THE SALESMAN HAS HIS FOOT IN THE DOOR

Regardless of any differences of public opinion over foreign policy, there has been almost unanimous approval of the Treasury's defense savings bond campaign. It is a sign that the salesman has his foot in the door.

Papers in the Midwest where anti-war sentiment is particularly strong, and notably papers that have been outspoken against Administration foreign policy, such as the Chicago Tribune and the St. Louis Post Dispatch, have been among those to endorse it. Even such an isolationist as John T. Flynn has written in his column: "There is no doubt that the only sound way for the Government to borrow money is from citizens instead of from banks."

To date, clippings returned to the Defense Savings Staff total more than 2600. The big bulk of these are news stories. Of that group, 600 were published before the bonds were placed on sale. Most of these were given good placement, and contained most of the points featured in the original release, e.g., that the bonds are intended for everyone -- with emphasis on the

- 2 -

"little man"; that this is no Liberty Loan drive, but is a campaign for systematic savings; that buying a bond is buying a share in national defense; and that the bonds will be a barrier to inflation.

Newspaper coverage has been divided as follows:

News stories	80%
Features and pictures	9%
Comments by columnists	5%
Editorials	5%
Cartoons	1%

In addition, banks have placed institutional advertisements running from quarter-page to full-page in nearly 200 newspapers. These feature the sale of defense stamps and bonds.

The first phase of the defense savings campaign has concentrated on the announcement of the bonds to the public. With minor exceptions -- practically the only papers that did not like the idea were the Daily Worker and Social Justice -- the drive in terms of newspaper copy has been successful.

The second phase of the campaign will emphasize how well the bonds are selling. This is particularly important in that the American public has a "nothing succeeds like success" psychology. The people must be persuaded that it is a band wagon they are getting on.

While two or three financial stories in New York newspapers ten days ago suggested that the bonds were not going so well, there has been no spread of this type of newspaper copy.

## TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE May 16, 1941

TO Secretary Morgenthau  
FROM Alan Barth

MARKING TIMEFlight

The Mysterious Adventure of Herr Rudolf Hess has brilliantly illuminated the tension which prevails in the United States. Perhaps because, momentarily, this romantic interlude served to snap suspense, and because it furnished a brief respite from intolerable reality, it was sensationally welcomed by press and public alike.

Most American newspapers managed to laugh at their own excitement over an incident which some of them confess should not be taken too seriously. But this did not keep them from every conceivable variety of speculation and conjecture as to the Nazi's mission. Innumerable letters to editors outdid even these editorial flights of fancy.

There was little tendency, however, to romanticize Hess himself. The common view here has been that he is a blackguard, fleeing from or sent by a pack of blackguards and that his own version of his case is no more worthy of credence than Hitler's.

The widespread hopes which his flight aroused indicate plainly, however, how near the surface were buried all the old, pathetic illusions about the imminence of a Nazi collapse through internal dissension. Since the naked realities of current events seem almost unbearable, Americans have imbibed the Hess adventure as a kind of intoxicant promising escape. For the moment it appears to have elevated their spirits. But it seems unlikely that the effects of such a spree will be more than transient.

Several of the more astute newspaper commentators agree that American uneasiness at present is due to a form of schizophrenia -- a split of the national personality, one portion of which desires ardently to remain at peace, while the other portion insists upon a defeat of the Axis. Until this internal conflict can be finally resolved and supplanted by a positive sense of direction, the daily news from abroad is certain to strike here upon jangled nerves and unhappy consciences. Americans cannot fiddle comfortably while London burns.

Public opinion polls now show plainly that this country has solved its problem on the intellectual level. It has been persuaded that the sensible thing for it to do is to aid the British -- even at the risk of war. But the vital responses of a nation are not rational; they are emotional. And this nation has not yet been fired emotionally or stirred to the sacrifices which are demanded for heroic action.

Facts

Admiral Land's letter to Senator Vandenberg on British shipping losses threw some cold water on those who have been clamoring that American naval intervention is immediately necessary. In several quarters it gave rise to irritated suspicion that the public has been deliberately bamboozled on the shipping problem by the interventionists. But in the main, the Land disclosures were seized as a peg on which to hang renewed demands for greater candor on the part of the Administration. There is an exceedingly widespread insistence that both the British and American Governments give the public the full facts about the progress of the Battle of the Atlantic.

Passage of the Ship Seizure bill was generally applauded, the delay over congressional action having previously evoked a good deal of impatience and acidulous comment. There appears to be little fear that even the delivery of German and Italian vessels to the British will be taken as a cause for war by the Axis.

Showdown

While press reaction to the seizure of French ships is not yet ascertainable, it seems virtually certain that this move will also be generally approved. A large portion of the newspapers which have been urging aid to Britain have shown small sympathy of late for the position of the French Government. There are frequent expressions of pity for the people of France and a

general assumption that the Vichy regime does not truly reflect their sentiments.

The recent moves by both France and the Soviet Union which have been taken as indicative of closer collaboration with the Axis have been greeted in rather defiant tone by most American editorial commentators. There is an increasing hostility to anything which may be labeled "appeasement." The shipment of food to France or of machine tools to Russia is deplored in a great many newspapers as futile or downright dangerous.

The feeling which now apparently dominates American editorial thought is that the time for a showdown has arrived. The United States, as well as France, the Soviet Union, Turkey and Spain, it is held, must soon definitively take sides. There will undoubtedly be an enormous sense of relief when the irrevocable choices are finally made. Until then, there can be only a nervous, impatient marking of time.

TREASURY DEPARTMENT  
INTER OFFICE COMMUNICATION

DATE May 16, 1941

TO Secretary Morgenthau  
FROM Herbert MerillatHEARINGS OF WAYS AND MEANS COMMITTEE  
Friday, May 16, 1941Distilled Spirits

The committee showed little interest in protests against increases in the tax on distilled spirits. Concerning witnesses' assertions that increased taxes would result in more bootlegging, Doughton remarked that stricter enforcement was the answer.

Non-defense Spending

With regard to frequent general suggestions for reductions in non-defense spending, Doughton and Buck are taking the line that witnesses should appear before the Appropriations Committee and make specific suggestions for cuts.

Pari-Mutuel Betting

With regard to a protest against a tax on pari-mutuel betting on the ground that such betting would be cut and illegal betting increased, Doughton remarked that he failed to see why a Federal tax shouldn't be imposed even if such were the result. In general, he is critical of all protests against excises proposed by the Treasury and Stam (except tobacco taxes).

May 16, 1941

Files

Mr. Cochran

At 3 o'clock this afternoon I discussed with Under Secretary Bell the letter of April 25 from Secretary Knox of the Navy in regard to the opening of a sterling account in London to cover disbursements made in that area by the Navy's Supply Officer in London.

With Mr. Bell's agreement, I telephoned Sir Frederick Phillips, British Under Secretary of the Treasury, at 3:20 this afternoon. I read Secretary Knox' letter to him. Phillips promised to think it over and give me his advice thereon. His first impression was that a direct account of our Treasury with the Bank of England would be the most satisfactory method of arrangement, provided we are not expecting interest on the account.



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P  
YCONFIDENTIAL

May 6, 1941

Sir:

Receipt is acknowledged of your communication of April 26, 1941 (80)LL-1/NF13) requesting that the Treasury make preliminary arrangements to provide for obtaining English currency for disbursement in London which, it is estimated, may average \$1,000,000 per month.

The Treasury will take prompt action in the matter and will advise you as soon as the arrangements requested are perfected.

Respectfully,

(signed) John L. Sullivan.

Acting Secretary of the Treasury.

The Honorable,  
The Secretary of the Navy.

EDB:ew 5-3-41

EDB WH H.M.C. WNT

eh:copy  
5-16-41

C  
O  
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Y

Address reply to  
The Secretary of the Navy  
and refer to initials  
and no.

NAVY DEPARTMENT  
Washington

132

April 28, 1941

(SC)11-1/EF13

CONFIDENTIAL

S I R :

The Navy Department is desirous that preliminary arrangements be made to provide for obtaining English currency for disbursing abroad if and when required.

To eliminate the selling of checks and bills of exchange, it would seem desirable that the Staff Supply Officer in London should have placed to his credit in a London bank, a deposit against which he could issue checks stated in English currency. It is estimated that average monthly requirements would be one million dollars (\$1,000,000.00).

With this deposit to his credit, the Staff Supply Officer would receive requests for funds from other disbursing officers in English waters and make transfers to the individual deposit accounts of these officers, the accounts to be carried in the same bank as the Staff Supply Officer's account.

Please advise if any arrangements as outlined above can be made.

Respectfully,

(S) Frank Knox

Frank Knox

The Honorable,  
The Secretary of the Treasury

eh:copy  
5-16-41

## TREASURY DEPARTMENT

## INTER-OFFICE COMMUNICATION

DATE May 16, 1941

TO Files  
FROM Mr. Cochran

Mr. John Russell of Honolulu telephoned me from New York this forenoon and asked for an appointment at 4 p.m. When he came in this afternoon he reported that following the message which I had given his office on the 14th, he had been able to complete his negotiations with Messrs. Peacock and Gifford. He is sure now that the transaction will be ended satisfactorily. When I told him that I had also taken the precaution of letting Sir Edward know that the Treasury had no objection to this transaction, he told me that he thought this conversation with Sir Edward had assisted considerably in the progress of the negotiations. He asked that I thank the Secretary warmly for the support which he has received in these negotiations.

While chatting on the general subject, Mr. Russell reported that he is definitely aware that Sir Edward is "putting the heat on" a number of British interests having holdings in this country. When Mr. Russell first visited Sir Edward's office several weeks ago, he found it cluttered up with a variety of individuals seeking commissions, etc. He says that it is now a serious place which gives a good impression. He was much pleased over his contact with Messrs. Peacock and Gifford and considers them entirely competent and qualified.



## TREASURY DEPARTMENT

## INTER OFFICE COMMUNICATION

DATE May 16, 1941

TO Secretary Morgenthau

FROM Mr. Kamarck

Subject: Airplane Deliveries to the British

Summary

1. Shipments for the latest week reported totalled 55 planes. This is just below the fourteen weeks average of 58 planes.
2. The heaviest shipment of naval patrol bombers to date was made in this week. The 8 Consolidated Catalina flying boats shipped were all delivered to England by air.
3. In this week, there was reported for the first time a shipment of 4 Grumman Martletts to England. These are single seat fighter monoplanes. The first shipment of 2 United Chesapeakes to the United Kingdom was also reported for the first time. These are single engine scout-bombers carrying a 1,000 pound bomb load.
4. If there is no objection, no attempt will be made to classify the light and medium bombers into separate types since the British appear to be using the light and medium bombers interchangeably for scouting, reconnaissance and bombing missions.

- 2 -

Division of Monetary  
ResearchAirplane Shipments to the British  
(From January 11 to April 19 by sea  
February 1 to May 10 by air)

Table A. - Shipments by Area

	Latest Week	Total Reported To Date
<u>To the United Kingdom</u>		
Light and medium bombers	31	250
Heavy bombers	1	10
Naval patrol bombers (Consolidated PBY)	8	41
Pursuit	<u>4</u>	<u>4</u>
Total to United Kingdom	44	304
<u>To the Middle East</u>		
Light and medium bombers (Martin 167)	5	116
Pursuit (Curtiss P-40)	<u>0</u>	<u>240</u>
Total to Middle East	5	356
<u>To the Far East</u>		
Light and medium bombers	0	6
Naval patrol bombers (Consolidated PBY)	0	5
Pursuit	6	88
Trainers	<u>0</u>	<u>55</u>
Total to Far East	6	154
<u>Totals</u>		
Light and medium bombers	36	372
Heavy bombers	1	10
Naval patrol bombers	8	46
Pursuit	10	332
Trainers	<u>0</u>	<u>55</u>
Grand Total	55	815

- 3 -

Division of Monetary  
Research

Table B. - Total Shipments by Types

	Latest Week	Total Reported To Date
Boeing B-17	1	5
Brewster Buffalo	6	88
Consolidated Cataline (PBY)	8	46
Liberator	0	5
Curtiss Tomahawk (P-40)	0	240
Douglas - Boston	0	81
Glenn Martin Maryland (Martin 167)	5	116
Grumman Martlett II	4	4
Lockheed Hudson I	0	1
Hudson III	0	36
Hudson IV	0	18
Hudson V	29	115
Electra	0	3
North American Harvard II	0	55
United Chesapeake	<u>2</u>	<u>2</u>
Grand Total - All Types	55	815

- 4 -

Division of Monetary  
Research

Table C. - Plane Deliveries to the British by Weeks

Week Ended	Light and Medium Bombers	Heavy Bombers	Naval Patrol Bombers	Pursuit	Trainers	Total
Feb. 8 *	22	-	3	-	-	25
Feb. 15 *	42	-	-	100	-	142
Feb. 22 *	35	-	-	27	-	62
Mar. 1 *	7	-	5	25	-	37
Mar. 8 *	16	-	3	10	-	29
Mar. 15 *	26	1	4	-	-	31
Mar. 22 *	17	-	2	22	-	41
Mar. 29 *	25	-	3	18	-	46
Apr. 5 *	21	-	7	73	-	101
Apr. 12 *	21	2	2	27	-	52
Apr. 19 *	20	3	4	5	-	32
Apr. 26 *	23	2	3	-	28	56
May 3 *	61	1	2	15	27	106
May 10	<u>36</u>	<u>1</u>	<u>8</u>	<u>10</u>	<u>-</u>	<u>55</u>
	372	10	46	332	55	815

\* The date given is for shipments by air. Shipments by water start three weeks earlier. That is, the statement reporting the shipment of planes by air for the week ending May 10 would report the shipment of planes by water for the week ending April 19.

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DEPARTMENT OF STATE  
ADVISER ON  
INTERNATIONAL ECONOMIC AFFAIRS

May 16, 1941.

To: Mr. Cochran

From: Mr. Livesey

Will you please return in due course.

Returned with thanks!

H.M.C.

(5-20-41)

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Memorandum of conversation with  
Mr. Ilsley, Minister of Finance.

---

I sat next to Mr. Ilsley at the luncheon for Mr. Mensies today. We talked a little about the budget and particularly his having raised the withholding tax on dividends and interest payments to non-residents. He explained that he was running into a great deal of trouble with certain parts of this tax and was being assured, from many competent quarters, that he was damaging Canadian credit in the American market. As far as raising the rate of the withholding tax on dividends from five to fifteen percent there was no difficulty, nor was there any on coupons which were payable in Canadian dollars. The trouble arose with coupons where the interest payment was specifically to be made in American dollar currency. For the most part these were provincial bonds, municipal bonds and a very few bonds of private corporations. Dominion bonds were specifically exempted in the budget. It is being alleged that coupons payable in a foreign currency are morally, if not legally, immune from a withholding tax.

Leaving aside ethics and law these bonds are held for the most part by mutual insurance companies and certain types of banks. Inasmuch as mutual insurance companies do not pay income tax in the United States they can not deduct the Canadian tax from their American income tax and hence take a serious loss. Many banks likewise have so arranged their portfolios that the great mass of their holdings are in tax free securities with just enough income from foreign bonds to balance the legitimate business expenses which they may charge off against their American tax. Both banks and insurance companies have been protesting violently at Ottawa.

I asked Mr. Ilsley how much was involved. He said that the Government had calculated in the budget on getting \$28,000,000 from the increase in the withholding tax. About \$12,000,000 would be lost if the Government should exempt municipal and provincial bonds payable in United States dollars. Of these \$12,000,000, \$4,000,000 were held in Britain and the financial arrangements between Britain and Canada were so complex that we might forget these \$4,000,000 altogether. That left \$8,000,000 at play. Should the Government exempt these coupons it would have to find \$8,000,000 somewhere else. Furthermore, there was a distinct hesitation in Cabinet to make an about-face. I suggested that this could be done on petition from the provinces and municipalities that their credit was being affected.

- 2 -

He admitted this but said there was still another difficulty. The bonds in question had dropped several points of late. Should the Canadian Government now reverse its position it would be unfair to those who had sold at a loss.

Mr. Ilsley admitted that this section of the budget had not been given sufficient thought but he added in strictest confidence it had been discussed with the United States Treasury and that the latter had raised no objections nor pointed out the complications which are already facing Ottawa.

Ottawa,

May 7, 1941.

PM/meh

COPY - 5/20/41 - dm

C  
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YMay 16, 1941.  
12:30 P.M.

Following phoned by Miss King, of Captain Phillips Office,  
O.N.I., (Navy 288):

From: Third Naval District, New York.

Reliable informant states situation in Banco di Napoli  
Trust Company, New York, Chicago and elsewhere very tense.  
Italian employees asked to prepare to leave for Buenos Aires  
when notified. Officers in United States fear Executive Vice  
President will flee country with bank's capital. They have  
asked assurances he will not and will hold meeting today.  
Italian employees clamoring to leave at once. F.B.I., M. I. D. and  
Immigration notified.

dm

MAY 16 1941

Dear Frank:

Reference is made to your memorandum of April 25, in which you brought to my attention an extract from a memorandum prepared by one of your officers returning from England to the effect that Lord Beaverbrook had instituted a system for keeping close track on all cases where information, written or verbal, was furnished to American personnel with the intention of assigning a value in each case and eventually presenting a claim for that value.

In my acknowledgment of April 25, I told you that I was having this matter investigated. Sir Frederick Phillips, Under Secretary of the British Treasury, presently in Washington, to whom I referred this matter, has now received word back through Lord Beaverbrook's agent, Sir Morris Wilson, to the effect that the above-mentioned report was "popycock", to use the exact language of the message.

Sincerely yours,

(Signed) Henry

The Honorable  
Frank Knox,  
Secretary of the Navy.

By Messenger 3<sup>46</sup>

HMC:dm:5.16.41

## TREASURY DEPARTMENT

## INTER-OFFICE COMMUNICATION

DATE May 15, 1941

TO Secretary Morgenthau  
FROM Mr. Cochran

While talking with Sir Frederick Phillips by telephone at 11:30 this morning, he referred to the letter which Secretary Knox had written Secretary Morgenthau some days ago, in regard to the keeping of books in London on military information given to American officials. Phillips told me that he had received word back through Lord Beaverbrook's agent, Sir Morris Wilson, to the effect that this report was "poppycock".



THE SECRETARY OF THE NAVY

Washington

CONFIDENTIAL

Apr. 25, 1941

MEMORANDUM for the Secretary of the Treasury.

SUBJECT: Possible Charges by British Government for Aircraft Information Supplied to the United States Government.

1. There is quoted below, as a matter of possible interest, an extract from a memorandum prepared by a naval officer recently returned from observer duty in England:

"I was informed while in London that Lord Beaverbrook had instituted a system for keeping close track of all cases where information, written or verbal, was furnished to American personnel, with the intention of assigning a value in each case and eventually presenting a claim for that value."

/s/ Frank Knox

CONFIDENTIAL

## TREASURY DEPARTMENT

## INTER-OFFICE COMMUNICATION

DATE May 16, 1941

TO Secretary Morgenthau

FROM Mr. Cochran

## STRICTLY CONFIDENTIAL

At 5:50 last evening Mr. Coyne, Financial Adviser of the Canadian Legation, telephoned me. He thought that we had given Mr. Clark and himself worthwhile advice to the effect that they should get directly in touch with Mr. Harry Hopkins in regard to the Lend-Lease proposition involving British-Canadian items. Mr. Clark had not gone directly to see Mr. Hopkins, since he learned that Mr. Purvis had an appointment yesterday noon, shortly after the hour at which I told Mr. Coyne the Secretary's message, transmitting the Canadian memorandum, had been delivered.

When Mr. Purvis returned from his interview with Mr. Hopkins he reported that the latter had the idea that the memorandum involved old contracts, and Hopkins had objections to taking these over. Coyne then got in touch with Mr. Hopkins by telephone and explained the matter in more detail than Purvis had apparently been able to do. Thereupon Mr. Hopkins told Coyne to go ahead with the plan, submitting two or three requests to try out the system. The Canadians will follow this advice at once.

Coyne told me further that while Mr. Purvis was present with Mr. Hopkins, Mr. Keynes arrived to discuss the question of lend-leasing with Hopkins. When it came to handling old contracts for the British, Hopkins insisted to Keynes that this had not been anticipated under the Lend-Lease Act and that the Director of the Budget had given testimony to the effect that these old contracts would not be included under the Lend-Lease system.

I gave the following information orally to the Secretary this morning. I told him further that Under Secretary Bell, Mr. Coe and I had met yesterday afternoon to go further into the questions raised by Keynes and Phillips with us. We had not endeavored to get in touch directly with Hopkins or his organization for further exploration. The Secretary approved the idea that we should do nothing further on this until next week. It is hoped that by Monday we may have the information requested by Under Secretary Bell from Assistant Secretary of War McCloy and also a memorandum from Mr. Keynes giving detailed data with respect to British requirements, and particularly as to the purchases which the British are not finding feasible to make under the Lend-Lease system.

I reported the above conversation to Under Secretary Bell as soon as I came out of Secretary Morgenthau's office.



## THE BRITISH SUPPLY COUNCIL IN NORTH AMERICA

TELEPHONE: REPUBLIC 7860

Box 680  
BENJAMIN FRANKLIN STATION  
WASHINGTON, D. C.The Hon. Henry J. Morgenthau, Jr.,  
United States Treasury,  
Washington, D.C.

May 16th, 1941

Dear Mr Morgenthau,

I now enclose the memorandum which you asked Phillips and myself to prepare for you. There is only one thing I should like to add to what is written in the text.

I believe that, if something of this sort could come to pass, there would be intangible advantages beyond those considerations of administrative convenience etc. which are mentioned in the enclosed. We have great anxieties and preoccupations, much to concern us and much to decide, in all parts of the world. It is natural, therefore, that sometimes we should worry a bit. The uncertainties of the exact financial arrangements over here in the past months - inevitable though they were in the light of the political and other difficulties - have weighed on the Chancellor of the Exchequer and his advisers, although at no time has he had any doubt that in the end, if we could have faith, all would be well. If from now on we could have a clean-cut settlement on the lines suggested, which would give us an immediately assured position against contingencies and remove all debateable points of any significance, it is difficult to exaggerate what a comfort this would be to everyone in the Treasury at home.

It is easy to argue, indeed I am sure it would be true, that many of our worries have been quite unnecessary and that we have wasted time and thought on what was certain to come right in the end. But in London it is difficult to be sensitive to the background in

Washington - it makes all the difference in the world to come here in person - and I stress, therefore, that the advantage of a clean-cut arrangement of the kind which the Chancellor of the Exchequer has instructed me to propose to you would be much more than is apparent on the basis of mere statistics and accounting and strict logic; and out of proportion to the sums involved, which are only a fraction of the vast assistance you are giving us.

I venture to say all this, since you will have a fellow-feeling for the Chancellor of the Exchequer in the burden he is carrying.

Yours sincerely,

JM Keynes

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MEMORANDUM.

1. Experience of Lease-Lend already shows that there are certain British requirements which are difficult to bring under Lease-Lend procedure because of either

- (a) mere administrative complexity or
- (b) legal or political difficulties under the Act.

This memorandum makes suggestions for a re-arrangement by which it is considered that these difficulties could be largely overcome without increasing total Lease-Lend appropriations. It is suggested that the difficult categories should be dealt with by ordinary purchase outside Lease-Lend altogether. This will naturally increase the current charges for which the British Government will have to find dollars, and correspondingly reduce the charges on the Lease-Lend appropriations of the U.S. Government. If a sum corresponding to these savings could be applied at the outset towards taking over existing British commitments, no net increase in total appropriations would be called for, but the British Government would be placed in a position to remove the "difficult" categories from Lend-Lease altogether.

2. As shown in Appendix A hereto, the categories which are likely to be administratively difficult (difficulty (a) above) appear to call for some \$200 millions per annum. For easing legal or political difficulties under the Act (difficulty (b) above) a figure of \$125 millions per annum is

- 2 -

provisionally suggested, but it would be for Mr. Hopkins to say what reserve he might think it prudent to set aside. Assuming, however, \$125 millions for difficulty (b), the total requirement to make this scheme effective would be \$325 millions per annum, so far as the U.K. is concerned.

3. The question of the provision to be made for supplies (whether strictly warlike or other) to the Sterling-using Dominions is still uncertain. But:

- (a) if nothing - i.e. not even strictly warlike supplies - is lease-lent to the Dominions, a further provision would have to be made under this head.
- (b) if, however, strictly warlike supplies are lease-lent to the Dominions, no addition would be needed to cover the purchase of non-warlike supplies, since Sir F. Phillips' estimates already submitted to Mr. Morgenthau assumed as a statistical basis that the U.K. would have to find the main part of the dollar finance for such supplies.

4. Thus, assuming no addition on account of the Dominions, the total amount which would be removed from the scope of Lease-Lend under these proposals would be \$325 millions a year, which would, of course, result in a corresponding reduction in the charges on Lease-Lend appropriations.

As explained in # 1, the proposal is that a sum corresponding to these savings should be applied at the outset in taking over existing British commitments. But, since this method of providing relief against existing commitments has to be applied at this stage or not at all, it would seem advisable to provide for two years' requirements at the present time, making \$650 millions for the two years.

5. Since this \$650 millions relief from existing commitments would subsequently be re-absorbed by cash payments on new commitments outside Lease-Lend, it would be additional to the relief of \$300 to \$400 millions already agreed by Mr. Morgenthau in his interview with Sir Frederick Phillips on March 19th. (It will be recalled that this referred to contracts which the Army and R.F.C. would take over). Thus the total relief from old contracts would be \$950 - \$1050 millions (less some \$70 millions which represents progress already made towards the \$300 - \$400 millions referred to above). As payments due under the existing contracts outstanding on May 1 were approximately \$1,300 millions and advance payments outstanding at that date \$700 millions, making a total of \$2,000 millions, there is ample scope now to cover the \$950 to \$1050 millions mentioned above. In six months' time, however, this would become difficult or impossible as the existing commitments are running off rapidly.

6. The advantages claimed for this re-arrangement are the following:-

- (1) The Lease-Lend Act would be restricted to materials directly related to warlike purposes and to agricultural products; with the elimination of marginal cases, no further questions of the eligibility of any materials under the Act would arise, and the U.S. Government could claim that the Act had been administered much more strictly than its wording required;
- (2) The administrative burden on both Governments would be greatly reduced with a gain to efficiency and to promptness of action.
- (3) If the British Treasury had a reasonable reserve against contingencies, both they and the American Administrator of the Lease-Lend Act would be subject to much less embarrassment whenever items came forward which the latter felt to be for any reason open to criticism, since the British Treasury would have no difficulty in accepting those criticisms immediately. It would also mean that the British Treasury could take the responsibility of itself financing any entirely unforeseen requirements which might develop, which it might be difficult for legislative reasons to bring within the ambit of the Lease-Lend procedure except after an inevitable delay.
- (4) If the British Treasury were relieved from a position where their resources are

likely to fall to a dangerously low level in the near future, they could face with far greater assurance the various unforeseen risks and contingencies which may face them in any part of the world during the particularly anxious period of the ensuing twelve months.

- (5) All this would be achieved without inflating the total appropriations which would be required under the Lease-Lend Act as compared with the alternative course now in operation, of working that Act as hard as possible and bringing under it virtually all British purchases in U.S.A.

Washington, D.C.  
May 16, 1941

APPENDIX A

The Break-up of the total of \$200 million referred to above is as follows:-

	(1)	\$ million
Certain Machinery components etc.		40
Certain chemical manufactures, drugs	(2)	30
Sundry materials, machinery and consumption goods		18
Vehicle parts		8
Civil road vehicles, including fire pumps, cranes etc.		24
Abrasives		4
Rutile, Bentonite, Diatomaceous Earth, Tin Residues and certain minor non-ferrous metals		6
Timber other than aero-sitka and aero plywood		10
Bagasse: other paper, cotton and linen rags,		7
Borax, Razorite, Sundry chemicals, Fibrestos & Synthetic Resins, Carbon black, Pine Tar Rosin, Turpentine and Asphalt		6
Agricultural Machinery		12
Agricultural Seeds		4
Oil Plant Equipment		30
		<u>199</u>

Note: The inclusion of a description in this table does not necessarily mean that the whole of that description will be "difficult". The values attributed above are intended to refer only to the "difficult" part of such categories.

It should be stressed that all these articles are essential, having been subject to the strictest criticism, and that many of the larger items, particularly machinery components, are in fact used for defence purposes. Some of these essentials, however, are for use or consumption on private account, and in all the above cases

- (1) The heading 'machinery components' comprises, inter alia, miscellaneous wireless apparatus, accumulators and parts, electrical heating and cooking apparatus, electric lighting apparatus, air and gas compressors, boot and shoe making machinery, hydraulic, pneumatic and separating machinery, prime movers, pumps, textile and knitting machines, bearings (a very large item), and scientific instruments.
- (2) The heading 'sundry materials' comprises such diverse requirements as brass screws and fittings, implements and hand tools,

it is difficult to isolate and route them for purchase through the Lend-Lease procedure.

Many of the above products are highly specialised, are bought to particular specifications and in comparatively small quantities from particular U.S. suppliers. A large part of the machinery demand is not for machines as such, but for bearings, parts etc. Many of the requirements mentioned are obtained by English firms from U.S. suppliers with whom they have maintained close trade connections for many years, and it would be a great waste of effort to interpose official machinery on both sides of the Atlantic between the regular purchaser and the regular supplier. It is relevant in this connection to point out that the import licences for the U.S.A. outstanding on March 15th last (to select a recent date at random) were over 10,000. Apart from the administrative difficulty of handling the question of purchase, the reception, storage, distribution etc. of the goods after arrival in the United Kingdom would require the establishment of a special Government organisation. At present such arrangements are carried out through the ordinary channels of trade. Given the very large number of transactions, documents etc. which would have to be handled, the administrative difficulties would be out of all proportion to the sums involved.

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(Note to page 1 continued)

- (2) needles for sewing machines,  
hosery machines, refractory bricks,  
electrical testing apparatus,  
moulding and presses.



TREASURY DEPARTMENT  
PROCUREMENT DIVISION  
WASHINGTON

OFFICE OF THE DIRECTOR

May 16, 1941

MEMORANDUM TO THE SECRETARY:

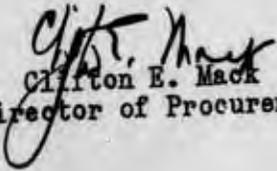
Weekly Report - Lease-Lend Purchases  
(5/10 - 5/16/41)

Purchases to 5/9/41.....	\$ 2,482,371.36
Purchases 5/10 to 5/16/41.....	1,571,178.26
	<hr/>
Total to 5/16/41.....	\$ 4,053,549.62

<u>Requisitions Pending</u>	<u>Estimated Cost</u>
Cleared by O.P.M. ....	\$ 157,968,883.95
Awaiting clearance by O.P.M. ....	9,892,668.64
	<hr/>
Total pending requisitions.....	\$ 167,861,552.59

Included in the above figures are requisitions for metals totaling \$118,000,000.00.

Contracts for fifteen transport planes amounting to \$1,455,726.16 were concluded this week.

  
 Clinton E. Mack  
 Director of Procurement

THE WHITE HOUSE  
WASHINGTON

MAY 16 1941

My dear Mr. Secretary:

I find that:

(1) The defense of the United Kingdom is vital to the defense of the United States;

(2) Sections 4 and 7 of the Act of March 11, 1941 have been complied with by the necessary agreement on the part of His Majesty's Government in the United Kingdom;

(3) It would be in the interests of our national defense to transfer the defense articles set forth in the annexed schedule.

I therefore authorize you to make the transfer to His Majesty's Government in the United Kingdom of the defense articles set forth in the annexed schedule.

I would appreciate it if you would arrange with the Chairman of the British Supply Council in North America for the time, method, and other details of the disposition.

Very sincerely yours,



The Honorable

The Secretary of the Treasury

**Defense Articles Authorized  
for Transfer to the United Kingdom  
by the Secretary of the Treasury**

Requisition Number	Quantity	Articles	
		Description	
289	3,018 500	Stanley, Vacuum Bottles, 1 pint size, No. 9058 Stanley, Jug, stainless steel lined, 1 gallon size.	
345	40 80 80	Model H Type 205109 Rope Starter Motors Model B Type 300261 Rope Starter Motors Model Z Type 304106 Rope Starter Motors	
349	24	Harvester Threshers	
356	5,000	18" Diameter Dished Heat Treated Discs, 10 gauge with 1-3/4" concave and 1-1/16" square hole in centre with polished back bevel and varnished	
383		Spare Parts for Surge Milking Machine	
384	1	Clipper Combine, 6 feet P.T.O. with Bagger Soourklean and pick up attachment	
385		Spare Parts for Agricultural Implements	
420	4	No. 22 Threshers	
426	6	1000 Gallon Etnyre "MX" Model Distributors with Barrel Hoists and 12 Months Supply Spare Parts.	
427		Tractors, Plows, Cultivators etc. From Simplicity Mfg. Co. also repair parts	
436	6	No. 12A Power Driven Combines Equipped with Sacking Attachment with Straight Sacking Spout and Auxiliary Auger. Without Hart Seed Cleaner and Grain Tank, with Three Sickles (AP 11914) and Hook-up for John Deere Model "A" Tractor	

Requisition Number	Articles	
	Quantity	Description
421	Any amount of the 132,832 tons covered by the requisition which becomes avail- able for transfer by September 30, 1941.	Prime Western Virgin Slab Zinc
588	50 short tons	Paris Green Packed in 50 Pound Net Tin Containers.

MAY 16 1941

Dear Mr. Mack:

This will acknowledge receipt of your letter of May 6, 1941 with respect to payments due the United Kingdom Commercial Corporation for Turkish chrome ore purchased for your stockpile. I do not think it would be desirable at this time to attempt to offset payments due under this contract against materials furnished the British under the Lease-Lend Act.

Sincerely yours,

(Signed) H. Morgenthau, 577

Secretary of the Treasury.

Hon. Clifton E. Mack,  
Director of Procurement,  
Treasury Department,  
Washington, D. C.

JJO'C.Jr/Lsw  
5-12-41

File to Mr. Thompson

By Messenger 3<sup>05</sup>

COPY

Office of the  
Director.TREASURY DEPARTMENT  
Procurement Division  
Washington

May 6, 1941

The Honorable

The Secretary of the Treasury

Sir:

The Procurement Division has contracted with the United Kingdom Commercial Corporation for 100,000 tons of Turkish chrome ore at a total price of \$2,100,000. Payment for this ore and the freight charges is to be made upon arrival in this country.

Mr. Oscar S. Cox was asked informally whether the Lend Lease Act was sufficiently broad to permit offsetting payments due the British Government on chrome ore, and it was his suggestion that this question be brought to your attention.

In addition to the chrome contract arrangements have also been made, through the United Kingdom Commercial Corporation, with representatives of the Indian Government for acquisition of stocks of munitions mica. While payment for this is to be made to agents of the United Kingdom Commercial Corporation, it would appear that since they represent transactions with the Indian Government they could not be considered in the same classification for offsetting purposes.

May we have your advice before concluding talks with the representatives of the United Kingdom Commercial Corporation relative to these payments.

Very truly yours,

(Signed) Clifton E. Mack,  
Director of Procurement.

Federal Reserve Building

5-9  
Foley at the time  
May 2, 1941.

Dear Clif:

I wish to thank you for your memorandum of April 29th, sending along Mr. Leaycraft's memorandum of April 28th, addressed to you, on the question of the payments to be made to the United Kingdom Commercial Corporation for chrome ore.

I would suggest that you send a memorandum direct to Secretary Morgenthau on this question. He is directly concerned with the master agreement which may be worked out between the U. S. and U. K. Governments under the Lend-Lease Act. My own tentative judgment is that, for the time being, the payments to be made by the United States for the chrome ore will not and should not be used as an off-set against the amounts due to the United States for lend-lease transfers.

Sincerely yours,

Oscar S. Cox

Oscar S. Cox.

Hon. Clifton E. Mack,  
Director, Procurement Division,  
Treasury Department,  
9th and D Streets, S. W.,  
Washington, D. C.

OSC:djb

cc: Secretary Morgenthau  
Mr. Foley

TO: Mr. Oscar Cox 4/29/41

The attached supplements our telephone conversation this afternoon relative to chrome purchases and the question of whether the lend-lease provision calls for any action other than originally contemplated when purchase was made.

  
From Mr. Mack



TREASURY DEPARTMENT

Inter Office Communication

May 8, 1941

TO: Mr. Merle Cochrane,  
FROM: J. J. O'Connell, Jr.

Attached is a copy of a letter the Secretary received yesterday from the Director of Procurement. You will note that Mr. Mack raises what is essentially a policy question, namely whether he should pay the United Kingdom Commercial Corporation ( which is apparently owned by the British Government), for certain strategic materials purchased for stock pile purposes, or whether lease lend materials should be offset against the cost of the material purchased from the British.

Harry White suggested that I call the situation to your attention and that, after you have had an opportunity to consider it, you, he and I get together to discuss it.

/s/ Joseph J. O'Connell, Jr.

Enclosure.

## TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE MAY 16 1941

TO Secretary Morgenthau

FROM Mr. Foley

In accordance with the request contained in Mr. Thompson's memorandum of December 26, 1939, there is attached a summary report of studies or projects carried on in the Office of the General Counsel for the month of April, 1941.

*8127h*

SUMMARY REPORT ON STUDIES OR PROJECTS  
IN THE OFFICE OF THE GENERAL COUNSEL-  
APRIL 1941

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The following matters received attention in the Office of the Chief Counsel for the Bureau of Internal Revenue:

1. Low taxable income of mutual insurance companies.

Collector James J. Hoey (Second District, New York) has submitted a memorandum calling attention to the fact that mutual insurance companies other than life are either exempt under section 101 (11) of the Internal Revenue Code or, if subject to the tax imposed by section 207 of the Code, they are permitted to deduct the amount of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves. The result is that they have little or no taxable income. On the other hand, insurance companies other than life or mutual are subject to the tax imposed by section 204 and although they compete with mutual insurance companies they are required to pay substantial income taxes. In 1938 a 62-page report on the Federal taxation of mutual insurance companies other than life was prepared in the Chief Counsel's Office, discussing

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the present method of Federal taxation of mutual insurance companies other than life and the equity of such method. Recommendations were made therein for changes in the law. That report, or a copy thereof, has been submitted to the Legislative Counsel.

2. Exemption of American citizens in our possessions from Federal income tax on income from sources without the United States. Under section 251, Internal Revenue Code, United States citizens and domestic corporations in our possessions are generally not subject to Federal income tax on income from sources without the United States. Such persons, however, are generally liable to income tax imposed by the possessions, for example, in Puerto Rico and the Philippine Islands. It is noted, however, that no income tax is imposed by the Panama Canal Zone, and hence our citizens and domestic corporations as well as aliens living there are exempt on income from sources without the United States. A similar situation exists with respect to such taxpayers in Guam, American Samoa, Wake and our other Islands (other than the Philippines) in the Pacific. The problem is being

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studied with a view to determining whether legislation should be recommended.

The above matters were handled under the supervision of Mr. G. E. Adams, Head, Legislation and Regulations Division.

The following matters received attention in the Office of Assistant General Cairns:

3. Exemption of Defense Articles from Duties and Other Taxes. During the month of February, Mr. Dwan, Chief Counsel, Customs, prepared a redraft of a proposed bill initiated by O.P.M. to exempt strategic and critical materials from customs duties and internal revenue taxes in certain cases. This redraft was discussed with various legal and administrative officers of the Treasury Department and was then discussed with O.P.M. and R.F.C. The War Department subsequently prepared a somewhat broader bill for the exemption of defense articles from duties and other taxes and submitted it to the Bureau of the Budget, which asked for comments by the Treasury Department. Mr. Dwan prepared a letter to Budget commenting on the bill and attaching a proposed redraft. The letter and redraft were discussed with representatives

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of the War Department, O.P.M., R.F.C., and Procurement before going forward for signature.

4. Inter-American Coffee Agreement. Messrs. Everett Smith and Dwan, of the Customs legal staff, examined the text of a draft of a proclamation to put the Agreement into force in respect of the United States and of two Executive orders prescribing regulations for the execution of the obligations of the United States under the Agreement. Several amendments suggested by Dwan's office were incorporated in the instruments prior to the signature thereof. The review in question was undertaken in order to insure administrative feasibility and legal adequacy of their provisions. The President's proclamation, signed April 15, 1941, has been published as a Treasury Decision, and it is expected that the Executive order allocating according to types the coffee quota established by the Agreement for countries not signatory thereto, signed April 21, 1941, will be published in an early issue of the weekly Treasury Decisions together with the public notice of the Secretary which is required by the terms of that Executive order.

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5. Currency conversion. A representative of Dwan's office, Mr. Everett Smith, joined Mr. Cairns and Mr. Feidler in a conference with Mr. Rufus Trimble, Mr. McKeon and Mr. Lang of the Federal Reserve Bank of New York at the Bank in a discussion of a draft of an amendment to section 522 of the Tariff Act of 1930. Mr. Logan, General Counsel of the Federal Reserve Bank, was present during the latter part of the conference. The representatives agreed upon a final draft of an amendment and also agreed that such draft, if finally approved by the Treasury Department, would be submitted to the Federal Reserve Bank of New York for its final approval. It was understood that if finally approved by both the Treasury Department and the Bank, the proposed bill would be transmitted to the Congress for consideration and would be supported by both the Treasury Department and the Bank. A letter submitting the proposed bill for the formal approval of the Bank prepared by the above-named representatives of the Treasury Department and signed by the Secretary has been sent to the Bank.

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6. Authority of Treasury officers to accept a proposed devise of property to the United States. An opinion on this question, prepared by Messrs. Feidler and Gilmore, and Miss Goode, of the Opinions Unit, was addressed to Mr. Bartelt on April 3, 1941. The question arose out of a proposed testamentary gift of property to the United States by Miss Martha Young of Raleigh, North Carolina. The opinion states the various ways in which gifts may be accepted: (1) by specific act of Congress, (2) by statutory authority to accept gifts for a particular purpose, (3) by implied authority to accept gifts for particular purposes, (4) by conversion of the property into money to be given unconditionally to the United States. The opinion suggests advising Miss Young to provide for conversion.

7. Transfer of part of Coast Guard functions, personnel, and equipment to Navy. This opinion, prepared by Mr. Feidler, and dated April 11, 1941, concludes that the transfer of part of the Coast Guard to the Navy is authorized by existing statutes, at the direction of the President.

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8. Payment of Government checks drawn by a particular disbursing officer after notice of irregularities in his accounts. An opinion to the Treasurer of the United States under date of April 23, 1941, concludes that the existing practice followed by the Treasurer's office of paying certain of such disbursing officer's checks should be followed, since it corresponds to commercial practice under similar circumstances. The opinion was prepared by Messrs. Feidler and Meeker.

The following work was handled under the supervision of Assistant General Counsel Bernard:

CONTINUATION OF PROJECTS

9. Bill to relieve the hospitals from double taxation under Harrison Narcotic Act (for description see original report, item 9). This bill and letters of transmittal therefor have been redrafted by Miss McDuff to comply with the recommendations made by the Bureau of the Budget in its letter dated March 28, 1941, addressed to the Secretary of the Treasury. This material has been sent forward for initialing.

10. Fidelity bond bill (formerly identified as "Bond Survey") (for description see original report, item 10).

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In accordance with recommendations which have been made by other departments and agencies, this bill, which was prepared by Mr. Spingarn, is being revised. It was submitted to Budget last year, and has been cleared with nine of the departments and establishments, though it has not yet received final Budget clearance. During the past month, several conferences were had with Mr. Bartelt about the changes that are being made in this bill, and as soon as such changes are completed, a conference will be arranged with Budget and G.A.O. representatives on this matter.

11. Federal Depository System (for description see original report, item 6). The Legislative Section is cooperating with Mr. O'Connell's office in making several minor changes in this bill to comply with the suggestions recently made by Under Secretary Bell.

12. Acting administrators bill (for description see June report, item 33). Work on this bill has been suspended for the time being.

13. Law Committee of Defense Communications Board (for description see November report, item 23). Mr. Spingarn

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is continuing his work as the Treasury representative on the Law Committee of the Defense Communications Board. Mr. Spingarn, as a member of a two-man subcommittee, prepared an opinion for the Law Committee on the legality of establishing traffic priorities in radiotelegraph, telegraph, and cable communications for governmental and other national defense traffic (1) in time of war, and (2) in time of national emergency short of war.

14. Codification of Public Debt laws (for description see December report, item 14). Work on this project has been suspended for the time being.

15. Survey of tax-exempt Federal securities, other than obligations (for description, see February report, item 7). In conjunction with Mr. Sullivan's office, Mr. Morton is continuing his study to determine what agencies, corporations, associations, etc., issue stock, evidences of indebtedness, and similar Federal securities, other than obligations, which are tax exempt. In connection with this study, he has prepared a draft of an amendment to the Public Debt Act, 1941, which will have the effect of removing the exemption from taxation of such securities.

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16. Administrative procedure bills (for description see April report, item 8). Mr. Koken is continuing his work on the coordination of the views of the staff members on the three pending Administrative Procedure bills, S. 675, S. 674, and S. 918, in order that the Department may be in a position to submit a detailed report to the subcommittee handling the bills which will show the impact of each bill on Treasury activities. Hearings on these bills commenced on April 2, 1941, and the Treasury's general views on the subject were explained to the subcommittee by Under Secretary Bell, Mr. Bernard, and others, on April 15, 1941.

#### NEW STUDIES

17. Proposed legislation to regulate production of opium poppies. In conjunction with the Narcotic Division, Mr. Morton is preparing legislation to authorize and regulate the production and distribution of opium poppies in this country. The need for this legislation arises from two factors: (1) Opium poppies are a source of poppy seeds, commercially used by bakers on rolls. The war has cut off the foreign supply of these seeds, and the result has been to increase enormously the domestic price of the

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seeds. (2) The war has also cut off our sources of crude opium, such as Yugoslavia. It will probably be necessary, therefore, for the first time to grow opium poppies in this country to make up the lack. This bill will be based principally upon the treaty power, but will also include the taxing power and interstate commerce power.

The following matters were worked on under the direction of Assistant General Counsel Bernstein:

18. Foreign Funds Control. Freezing control was extended to Greece, this office preparing the necessary papers. In connection with this extension of the control we had the problem of two New York banks engaging in a general banking business - and not merely agencies, that would be "nationals" under the Order. Since even a temporary delay in their operations might have resulted in the dishonoring of all checks drawn on the banks, the loss of public confidence, and extreme difficulty in returning to normal operations, it was necessary for us to draft a comprehensive license for their operation and time its issuance with the announcement of the Order. This operation was successful and

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there was not the slightest interruption in the banks' business.

The question of a general extension of freezing control again became active. Justice and State proposed a new draft of an Order which, among other things, vested in the Economic Defense Committee broad powers to extend the freezing control on its order; authorizing ad hoc freezing; and in general coordinating the administration of freezing control and export control. This proposal was studied and this office drafted a counter-proposal which in effect established a committee to supervise the administration of freezing control and export control and to study the problem of economic defense in general. This draft is now receiving consideration.

The White House requested that in connection with the President's Public Papers and Addresses we furnish them with a memorandum dealing with freezing control. This office, with the cooperation of Monetary Research, prepared a note for the President's Papers on such subject.

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A question arose regarding the litigation between the Commission for Polish Relief, Ltd., and the National Bank of Rumania arising out of the alleged refusal of the Central Bank of Rumania to deliver over to the Polish Central Bank certain gold. The plaintiff had attached the assets of the National Bank of Rumania in New York and application had been filed with the Treasury Department to permit the transfer of such assets to the sheriff in order to perfect attachment proceedings. It was decided, after consultation with the State Department that no affirmative action permitting the transfer of such funds should be taken at this time and the application was denied.

This office participated in the redrafting of the basic license issued to banks in the United States holding balances for foreign banks subject to the Order but which are not in the occupied area. The new license deals with the operation of such foreign banks in a somewhat comprehensive manner.

A case arose in which the Incasso Bank in the Netherlands gave instructions to the Central Hanover

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Bank and Trust Company to sell a large block of securities from their portfolio. The Central Hanover Bank could not obtain authorization from the Dutch Legation to effect such sale and turned to the Treasury Department for protection against the conflicting claims. The whole matter of consistency of approach by the Dutch Legation and the Treasury Department was already under consideration and the Treasury hesitated to take definitive action in the premises, particularly since General License No. 4 authorized the sale in question. This office brought to the attention of counsel for the Central Hanover Bank the provisions of the recent amendment to the New York Banking Law relating to instructions from certain territories, and on the basis of the protection afforded by such statute, Central Hanover was satisfied in the premises.

This office participated in the setting up of a series of "clearing" agreements with French Indo China, Madagascar, North Africa and Syria. In the case of French Indo China, Rubber Reserve and Metals Reserve

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were interested in obtaining rubber and certain critical minerals. Since the Indo China accounts were blocked, the French would not furnish these materials unless we agreed to issue licenses permitting them to make use of the sums received in payment, as well as certain other concessions with respect to certain other blocked funds. The matter was the subject of several conferences with the interested Government departments and arrangements were effected. In the case of Madagascar, we were interested in obtaining graphite and mica and a similar agreement was made. Syria and French North Africa, while not furnishing us with strategic commodities, were accorded modified clearing arrangements at the request of the State Department.

The entire staff worked on these matters.

19. Transactions under Federal Reserve Act amendment.

The following transactions were effected pursuant to the provisions of the Act of April 7, 1941, amending Section 25(b) of the Federal Reserve Act, as amended:

- (a) Transfer of \$100,000 from the account in the name of the Central Bank of Yugoslavia at the Federal Reserve

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Bank of New York to an account in the name of the Royal Yugoslave Legation at the Hamilton National Bank, Washington, D. C.

(b) Transfer of approximately \$21,000,000 in the dollar account and gold valued at approximately \$46,000,000 in the gold account, in the name of the Central Bank of Yugoslavia at the Federal Reserve Bank of New York, to dollar and gold accounts at the Federal Reserve Bank of New York in the name of the Government of Yugoslavia.

(c) Authorization to the Yugoslavian Minister to withdraw not exceeding \$10,000,000 during the period of a year from the dollar account established at the Federal Reserve Bank of New York in the name of the Government of Yugoslavia.

(d) Authorization covering the withdrawal of funds from accounts in the name of the Danish Legation at the Riggs National Bank, Washington, D. C.

These transactions involved the issuance of appropriate licenses; notifications to the State Department of the issuance of such licenses; certifications by the

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Ministers of Yugoslavia and Denmark as to their authority over the accounts; certifications by the State Department with respect to the authority of the Ministers to effect the transactions; and instructions to the banks involved by the Ministers.

In addition to preparing licenses and notifications, there were also prepared, in each case, drafts of the documents required to be executed by the State Department and the Ministers. Mr. Bernstein and Mr. DuBois worked on this matter.

20. Spanish silver. This office worked on the problem of the charges to be made by the New York Assay Office for the melting and refining of silver coin purchased from the Government of Spain and cooperated with Mr. Dietrich and the Mint Bureau in the drafting of appropriate letters of instruction to the New York Assay Office as well as a letter to the Spanish Ambassador with respect to the Mint charges for melting and refining which will be deducted from the final payment to the Spanish Government. Mr. Bernstein, Mr. Sutton, and Miss Hodel worked on this matter.

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21. Shipments of gold from Bank of China to New York Federal Reserve Bank. This office cooperated with Mr. Dietrich and the Bureau of the Mint in working out the appropriate procedure for the deposit of two shipments of gold from the Bank of China at the Federal Reserve Bank of San Francisco for the account of the New York Federal, the payment to be made by the New York Assay Office to the New York Federal. Mr. Bernstein and Miss Hodel worked on this matter.

22. Movement of silver to West Point Depository. This office cooperated with the office of the Chief Counsel at Procurement and with the Bureau of the Mint in the drafting of instructions to bidders, the necessary bonds, and the form of contract which were approved and used in connection with the contract for the moving of about 150,000 ounces of silver to the West Point Depository. Mr. Bernstein, Mr. Groman, and Miss Hodel worked on this matter.

23. Mexican Claims litigation. A bill of complaint having been served on March 3, 1941, in the case of

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Nugent v. Morgenthau, et al., in the District Court for the District of Columbia, a letter to Justice was prepared suggesting in detail answers to the allegations of the bill of complaint and also suggesting motions to dismiss, and copies of relevant documents were transmitted. Mr. Bernstein, Mr. Sutton, and Mr. Johnston worked on this matter.

24. Stabilization and dollar devaluation powers. We drafted letters for the President to send to the House and Senate Committees recommending extension of these powers until June 30, 1943. Mr. Bernstein worked on this matter.

25. Ida Werfel v. Zivnostenska Banka. This is a case now in the Court of Appeals of the State of New York in which the Department of Justice is appearing as amicus curiae and involves a suit by a person in this country against the assets of a Czechoslovakian bank. We discussed with Justice the wisdom of appearing in this action and the nature of the argument to be made. Mr. Bernstein and Mr. Friedman worked on this matter.

26. Konversionskasse Bonds. Pursuant to a request of Justice we have drafted a memorandum on the legality of

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the sale of Konversionskasse bonds in exchange for Reichsmarks acquired by American business institutions. We are awaiting some material on the economic aspects from Dr. White's office. Mr. Bernstein and Mr. Friedman worked on this matter.

26. Anglo-Palestine Bank. We had a number of conferences with Istorik on the matter and prepared a memorandum for the Secretary and a letter which the Secretary sent to Mr. Istorik, a copy of which was furnished to the British Embassy. Mr. Bernstein worked on this matter.

27. Chinese Stabilization Agreement. We have put in final form all of our papers in connection with this arrangement and checked over the papers executed by the British and Chinese in connection with the British-Chinese arrangement. The Chinese Agreement was signed by the Treasury and the Chinese on April 25. Mr. Bernstein worked on this matter.

TREASURY DEPARTMENT  
INTER OFFICE COMMUNICATION

DATE May 16, 1941

to Secretary Morganthau

from Mr. Cochran

**CONFIDENTIAL**

Registered sterling transactions of the reporting banks were as follows:

Sold to commercial concerns	£100,000
Purchased from commercial concerns	£ 37,000

Open market sterling was quoted at 4.03-1/4. Transactions of the reporting banks were as follows:

Sold to commercial concerns	£7,000
Purchased from commercial concerns	£2,000

The Canadian dollar advanced to close at 13-11/16¢ discount, as compared with 15-1/16¢ last night.

The Cuban peso, which touched a new current high of 2-1/16¢ discount yesterday, reacted to close at 2-7/16¢ today.

In New York, closing quotations for the foreign currencies listed below were as follows:

Swiss franc	.3330
Swedish krona	.2385
Danish mark	.4005
Lira	.0905
Argentine peso (free)	.2375
Brazilian milreis (free)	.0905
Mexican peso	.2066

In Shanghai, the yuan in terms of our currency was unchanged at 5-11/32¢, and sterling was again quoted at 3.90-7/8.

There were no gold transactions effected by us with foreign countries today.

The Treasury issued a license under the Gold Reserve Act permitting the Federal Reserve Bank of New York to effect the following transfer of gold in its vaults:

\$1,134,000 from the account of the Bank of Finland to the account of the Bank of Sweden.

MAILED  
MAY 16 1941

No new gold engagements were reported to us today.

In London, the price fixed for spot silver was  $23\frac{1}{2}d$ , up  $1/16d$ . The forward quotation declined  $1/16d$  to  $23\frac{7}{16}d$ . The U. S. equivalents were  $42.67¢$  and  $42.5¢$  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  $34\frac{3}{4}¢$ .

We made two purchases of silver totaling 250,000 ounces under the Silver Purchase Act. This consisted of new production from Peru, and was bought for forward delivery.



**CONFIDENTIAL**

BRITISH EMBASSY,  
WASHINGTON, D. C.

May 16th, 1941.

Personal and Secret.

Dear Mr. Secretary,

I enclose herein for your  
personal and secret information a copy  
of the latest report received from  
London on the military situation.

Believe me,

Dear Mr. Secretary,

Very sincerely yours,

*Halifax*

The Honourable

Henry Morgenthau, Jr.,

United States Treasury,

Washington, D. C.

## Telegram from London dated May 14th.

1. Naval. During Fleet operations in the Central Mediterranean between May 6th - 12th, 9 enemy aircraft shot down and 1 damaged; our losses 5 Fulmars and 2 Albacores, only 2 were due to enemy action.
2. A.M.C. believed "Salopian" reported torpedoed and abandoned A.M./13th 650 miles Southwest of Iceland (#).
3. Bulolo P.M./13th intercepted French 4484 ton ship about 100 miles south west of Dakar. She carried 400 native troops for Madagascar.
4. At 20.30/12.4 naval aircraft attacked convoy on passage Tripoli hitting 1 destroyer and one 8,000 ton merchant vessel.
5. Military. Sollum Area. Early 12th. Enemy advanced in several columns with approximately 30 armoured cars and 30 tanks; Afternoon. Air and ground reconnaissance reported enemy columns had converged and were stationary near Bir Sofari; Evening. Whole force was reported to have withdrawn while successfully bombed and machine gunned by 22 Hurricanes and Blenheims. One Hurricane missing.
6. Ethiopia. Amba Alagi area. Operations are continuing satisfactorily and 200 Italian prisoners have been captured.
7. Royal Air Force. May 13th. Blenheim obtained direct hit on deck of "Nasaire" and claims to have destroyed it.
8. Night of 13th/14th. All bombing operations cancelled.
9. German Air Force. Day 13th. Enemy activity slight. 1 Dornier bomber shot down into the sea.
10. Night of 13th/14th. 40 enemy aircraft operated against shipping and 6 mine-laying.
11. Libya. May 12th. 46 enemy aircraft bombed Tobruk harbour, hitting 2 anti-aircraft gun positions. Our anti-aircraft defences probably destroyed 3.

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12. Malta. Night of 11th/12th. Luqa aerodrome attacked by 30 enemy aircraft. 1 hanger hit and Maryland (Glen Martin light bomber) burnt and two others destroyed. Following night attack repeated; damage caused in dock yard.

BRITISH EMBASSY,  
WASHINGTON, D. C.

PERSONAL AND  
SECRET

May 16th, 1941

Dear Mr. Secretary,

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personal and secret information a copy  
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Believe me,

Dear Mr. Secretary,

Very sincerely yours,

*Halifax*

The Honourable,  
Henry Morgenthau, Jr.,  
United States Treasury,  
Washington, D.C.

TELEGRAM RECEIVED FROM LONDON

DATED MAY 15th, 1941

Ladybird after long period on North African coast during which she regularly successfully bombarded enemy forces and positions was sunk by two direct hits from dive bombers Tobruk harbour p.m. /12th. After-part .... of disintegrated remains on fire many hours. Foremost gun continued firing after the ship hit and on fire.

2. Suez Canal closed Port Said to Kantara, Lake Tamsah to Great Bitter Lake.

3. A.M./14th Fokke Wulf A/C sank Norwegian ship in outward convoy western approaches but Wellington aircraft drove it off convoy.

4. 14 Beaufort aircraft torpedoed 5000 ton merchant ship out of convoy of 5 off IJmuiden. Both battle cruisers sighted Brest; balloon barrage was seen.

5. Night of 12th/13th Suda Bay attacked by single aircraft for 7 hours. No damage, no casualties.

6. IRAQ.

About 1000 Iraqis who withdrew from Basrah area are reported to be reforming at Qurna and Hammediya.

7. GERMAN AIR FORCE. Day 14th.

About 20 enemy aircraft came over land,

our fighters damaged four enemy bombers.

8. Night of 14th/15th.

About 50 aircraft engaged in mine-laying or against shipping; 1 destroyed in Humber by Naval Anti-Aircraft gunfire.

RESTRICTED

G-2/2657-220; No. 393 M. I. D., W. D. 12:00 M., May 16, 1941.

SITUATION REPORTI. Western Theater of War.

Air: German. Light and scattering attacks last night.

British. Normal night operations with principal effort against Hanover. Berlin, Hamburg and the French coast were also raided.

II. Mediterranean and African Theaters of War.

Ground: North Africa. British troops have occupied Sollum and Halfaya Pass. The latter controls the approach from the desert escarpment road to the coastal road. The British have advanced to Mu Saïd which is about four miles west of Sollum. This operation is believed limited in character.

East Africa. The British have captured Sciasciamanna in southern Abyssinia (Ethiopia).

Air: Axis. Attacks on Malta and Crete. Close support of ground forces at Tobruk and Sollum.

III. Middle Eastern Theater.

Iraq: Ground. Iraqi forces expelled from the Basra area are reorganizing at Hammadiya, just south of Baghdad.

Air. Believed that about 30 German planes have reached the theater. The R.A.F. is attacking Iraq troops and airdromes.

Syria: The British have bombed French airdromes, probably at Palmyra, Rayak and Damascus as a result of their use by German planes.

RESTRICTED

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MILITARY INTELLIGENCE DIVISION  
WAR DEPARTMENT  
Washington, May 16, 1941

TENTATIVE LESSONS BULLETIN  
No. 105  
G-2/2657-235

NOTICE

The information contained in this series of bulletins will be restricted to items from official sources which are reasonably confirmed. The lessons necessarily are tentative and in no sense mature studies.

This document is being given an approved distribution, and no additional copies are available in the Military Intelligence Division. For provisions governing its reproduction, see Letter TAG 350.05 (9-19-40) M-B-M.

BRITISH NOTES ON ESCAPE OF PRISONERSSOURCE

These notes are based upon the experiences of British prisoners in Belgium and Northern France at a time when these areas were passing into a state of organization. The information was published by the British War Office shortly after the fall of France.

CONTENTS

1. SEARCH, GUARDING, AND TREATMENT
2. OPPORTUNITIES FOR ESCAPE
3. PREPARATIONS FOR ESCAPE
4. PRECAUTIONS FOR ESCAPERS

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CONFIDENTIALBRITISH NOTES ON ESCAPE OF PRISONERS1. SEARCH, GUARDING, AND TREATMENT

Immediately after capture, prisoners of all ranks were compelled to surrender their arms and equipment, and sometimes their steel helmets and respirators also. Apart from this, they were searched only perfunctorily or not at all, and there was little or no attempt at interrogation in the first stage.

Officers were able to destroy documents, and the exercise of a little ingenuity enabled several of them to conceal and retain compasses, maps, money, pocket knives, and other articles which might be useful in an attempt to escape. In case of capture, the compass should be removed from the pouch and concealed in a pocket or other suitable hiding place.

There appeared to be no organized prisoner of war camps close to the front. Prisoners were marched back for several days in columns consisting of military or military and civilian prisoners. In the columns they were usually divided up by nationalities into officers, other ranks and civilians. Positions of the various groups in the columns varied.

The means of guarding prisoners usually consisted of machine guns carried on lorries at the head and tail and occasionally in the middle of the column, and of motorcyclists or bicyclists armed with rifles or sub-machine guns patrolling the length of the column or moving ahead and occupying points of vantage from which the column could be supervised. Prisoners were generally exhausted and there was much straggling. Officers or wounded were sometimes carried in lorries.

Prisoners were housed at night in convenient buildings, such as barns, huts, churches or halls, although on some occasions they remained in the open. There was little or no attempt to take names or to compile or call rolls on the march, and more often than not, heads were not even counted. Food at this stage was scarce and poor, and the general impression was that no very effective preparations had been made for dealing with large numbers of prisoners.

2. OPPORTUNITIES FOR ESCAPE

Opportunities to escape usually presented themselves soon after capture, and several prisoners made every effort to take advantage of such opportunities in spite of their physical condition. Most escapers managed to get away during halts on the march by slipping through gaps in hedges into ditches, or into woods while the guards' attention was distracted or the escapers' movements were concealed by

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others. In a number of instances, guards were confused by deliberate straggling, which caused breaks in the column, and which they were compelled to attempt to close up.

One officer, who had escaped previously and had been recaptured, procured civilian clothes and marched, after recapture, with the civilians in the column. He got away again by slipping into the crowd at the roadside when passing through a town. Another officer who had escaped and been recaptured was marched back by the same route in the following day's column. He again succeeded in making his escape, after he and his companion's movements had been cloaked by others, through the same hedge-gap that he had used on the previous day.

3. PREPARATIONS FOR ESCAPE

It was difficult to make any elaborate preparations for escape, but the following hints are probably worth noting:

- a. Save and conceal a portion of your rations, if possible.
- b. Obtain and fill a receptacle for water.
- c. If you have no compass or map, endeavor to obtain them.
- d. Try to procure an extra pair of socks.
- e. For money, try to get notes of small denominations.
- f. If several prisoners contemplate escape together, they should leave separately after arranging, if possible, a subsequent rendezvous. Rendezvous should be arranged at frequent intervals during the escape journey, since the party may get separated.

4. PRECAUTIONS FOR ESCAPERS

Great care had to be exercised by escapers in approaching civilians for aid or information. Many of them were very helpful despite their very natural fear of the consequences, but a number were most anxious to avoid all contact with escaped prisoners. It should be borne in mind that a civilian helps an escaped prisoner at the risk of his own life.

Unless and until civilian clothes can be obtained, an escaped prisoner should travel only by night and across country, avoiding main roads, towns, and people. He should hide during the daytime, but avoid woods as hiding places, since they might conceal other stragglers whose presence might give him away. Finding a loft, barn, or deserted house, the best cover is in the middle of a field with standing crops, provided

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harvesting has not begun. Once civilian clothes have been obtained, travel by day is practicable, main roads can be used, and large towns can be passed through in reasonable safety. Side roads and small villages should be avoided, as a stranger in the latter excites suspicion.

The following points, noted by one who escaped from France in civilian clothes, illustrate the importance of conforming to the habits of the country from which a prisoner is attempting to escape:

- a. Do not march in a military fashion, but adopt a tired slouch.
- b. Try to secure a bicycle; bicycles proved invaluable to several escapers.
- c. Do not wear a wrist watch; carry it in your pocket.
- d. Sling your haversack; the French peasant commonly carries one this way, but never as a pack on his back.
- e. Do not use a cane or walking stick; this is a British custom.
- f. Get rid of army boots and adopt, if possible, a pair of rope-soled shoes as worn by peasants.
- g. French peasants are generally clean shaven, although a slight growth of beard is not uncommon.
- h. A beret is a very effective disguise.
- i. Village priests are likely to be helpful. Care should be exercised in approaching them, and one should avoid being seen talking to them.

Escapers should notice everything they can of military importance both before and after escape. Many of them brought back valuable military information. It is probably advisable to avoid making notes unless they are in such a form that they can be easily destroyed in the event of recapture.

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Excerpt of Code Collection  
Received at the War Department  
at GPO, May 14, 1941.

London, filed 14:30, May 14, 1941.

Military authorities here say that Swiss, information is available as a source for the procurement of German military publications and maps in Germany. This information is submitted because they anticipate that we will have some difficulty, if we do not already, in obtaining such material, and they recommend that we attempt to procure whatever may be possible before the source of supply is shut off.

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**Distribution:**

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CONFIDENTIAL

# CONFIDENTIAL

200

Paraphrase of Code Cablesgram  
Received at the War Department  
at 08:32, May 16, 1941.

London, filed 14:30, May 16, 1941.

## 1. British Air Activity over the Continent

a. Day of May 15. Planes of the Royal Air Force bombed a convoy of five merchant vessels and three escorting ships off the Dutch coast. Three ships were set afire, one Axis plane destroyed and two damaged.

b. Night of May 14-15. Bomber operations from Britain were concealed, but planes from the Coastal Command mined sections of the French coast.

Royal Air Force fighters, on several offensive patrols over northern France, destroyed two Junkers Ju-52's and damaged a number of aircraft on the ground. The barracks and personnel of several airfields were also machine gunned.

## 2. German Air Activity over Britain

a. Night of May 15-16. Attacks were slight and scattered with several aircraft over the southwestern peninsula and as far north as Bristol. Single planes were over East Anglia, Lincolnshire and around London, and off the coasts of Liverpool, East Scotland and Bristol.

b. Day of May 15. German activity consisted mostly of patrols over the Calais area, and slight reconnaissance over the English coast.

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3. Aircraft Losses. British Theater

- a. No British losses reported.
- b. British fighters shot down one confirmed, one probable and damaged one plane during the German operations on the day of May 15.

4. British Air Activity. Other Theaters

a. Evrosian theater. Royal Air Force planes based in Egypt bombed airfields on the Isle of Rhodes, Benghazi railroad and harbor. Airfields at Rasouki, Derna and Benina were also attacked.

b. Irani theater. The Royal Air Force bombed Iraqi forces at Rashid and Mosul.

5. Axis Air Activity. Other Theaters

a. Evrosian theater. Axis planes made four attacks on airfields in Malta which resulted in some civilian damage. Crete was twice heavily bombed but with only slight damage.

6. Aircraft Losses. Other Theaters

- a. No British losses reported.
- b. Eight Axis planes were destroyed and one damaged during the bombing of Crete.

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CONFIDENTIAL

Paraphrase of Code Cablesgram  
Received at the War Department  
at 08:41, May 17, 1941.

London, filed 14:30, May 17, 1941.

1. British Air Activity over the Continent.

a. Day of May 16. The only air activity reported is the bombing of an unnamed German merchant ship off Bergen. This ship was sunk.

b. Night of May 15-16. One hundred and two British bombers attacked Hanover, 31 attacked Boulogne, Calais, Dieppe, and airfields in northwestern Germany, and 13 attacked Berlin. Flares from the Coastal Command attacked the "mosquito base" base at Ijmuiden, submarines and shipping at St. Nazaire.

2. German Air Activity over Britain.

a. Night of May 16-17. Enemy attacks were on a larger scale than previously had been the case. Principal objective was the Midlands, while some attacked south and middle Wales.

b. Day of May 16. German attacks consisted of almost continuous fighter sweeps in small formations in the vicinity of East Kent and the Channel.

3. Aircraft Losses, British Theater.

a. During the raids on the night of May 15-16, four bombers were lost.

b. During the enemy activity on the day of May 16, fighters destroyed five Messerschmitt Me-109's, one probable and five damaged, and antiaircraft fire destroyed two others. During the activity on the night of May 16-17, night fighters shot down two bombers.

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4. British Air Activity, Other Theaters.

a. Egyptian Theater. British planes bombed Bengazi Harbor, several airdromes, and enemy troops at Halfaya and Sollum. Fighters destroyed one and damaged two Axis aircraft, and machine-gunned troops between Tobruk and Bardia.

5. Axis Air Activity, Other Theaters.

a. Middle East Theater. The presence of at least 12 German troop-transporting planes in Syria has been noted and an undetermined number of Messerschmitt Me-109's and Heinkel He-111's are now operating over Iraq from Syrian bases. It has been definitely ascertained that the German air force headquarters has been established at Palmyra.

b. Iraqi Theater. Three German planes attacked British airfield at Habbaniya but no damage was done.

6. Aircraft Losses, Other Theaters.

a. During attacks on Malta, nights of May 13, 14 and 15, the British lost ten planes.

b. Four German aircraft were damaged at Palmyra. In Iraq one German plane was destroyed and one damaged. In the attack on Habbaniya airfield one Heinkel He-111 was shot down. During attacks on Crete, May 13 and 14, Germans lost nine planes.

7. The Suez Canal has not yet been opened.

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 Air Corps

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**SECRET**

By authority A. C. of S. 1-2

Date **MAY 19 1941**

Initials

**204**

Paraphrase of Code Cablegram  
Received at the War Department  
at 04:57, May 17, 1941.

Cairo, filed 22:40, May 15, 1941.

1. On May 5, concentration of German motor torpedo boats was observed in the Black Sea.
2. Six Nazi vessels have been observed transiting from the Black Sea to the Aegean. One was the Arcadia with a heavy load of unknown character aboard.
3. Sixteen assault boats powered by outboard motors were employed by the Germans in the capture of the Thasos. The outboard motors developed 200 horsepower each and can be transported by 8 men. Samothrace was occupied by elements transported on 2 tankers and 1 transport. In the taking of Rhios, 1 freighter and 2 torpedo boats were employed. There is now a force of 800 men on the island. On May 6 the Germans captured Santorini and on May 12, Antikythera. Fifty Germans are garrisoning Spalmatori.

FELLERS

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Secretary of War  
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Office of Naval Intelligence  
G-3

**SECRET**

**SECRET**

By authority A. C. of S., G-2

Date MAY 20 1941 ( )

Initials

205

Paraphrase of Code Cablinggram  
Received at the War Department  
at 14:40, May 17, 1941.

London, filed 14:20, May 17, 1941.

1. In reference to the Heinkel 4-engine bomber in your cable of May 8th, it is believed to be the He-177 reported to be in small scale production at the present time.

2. Present available information indicates that the German Air Force has had considerable trouble with He-177 prototypes. On trials at least two have crashed. A small number of He-177's are now in production and will shortly go into service the British believe.

3. The original prototype of this bomber was powered with two 12 cylinder Mercedes-Benz DB 606 engines with maximum output of 2200 h.p. per engine at 15,000 feet. The Mercedes-Benz DB 606 engine is reported to be two 12 cylinder units driving one propeller, one unit can be cut out in the event of engine failure, probably by declutching. It is probable that another He-177 version having four 12 cylinder DB 603 engines totaling 5600 h.p. maximum as against original twin-engine prototype totaling 4400 h.p. maximum.

4. The nearly complete data on He-177 follows; due to conflicting figures it might indicate the considerable modification of the original prototype:

Low wing monoplane with retractable landing gear. Length, 67 feet; span, 103 feet; wing area, 1100 sq. ft.  
(presumably gross.)

Crew, 5 to 6 (original report, but due to size of airplane crew estimated at 8 to 10 by British. Crew of 14 as

**SECRET**

**SECRET**

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quoted in round figures in your cable of May 8th may be for long range reconnaissance type reported to have twenty hour endurance.)

Weight (flying) - 65,000 lbs.

Speed - Maximum 340 m.p.h. at 18,000 feet. (Original report seems excessive.) British estimate 290 to 300 m.p.h. at 17,000 feet approximately.

Ceiling - 23,000 feet.

Range - 1000 miles with bomb load of 13,000 lbs. (British estimate of maximum.) Report states 20 hour version with reduced bomb load for reconnaissance.

Armament - Nose and tail turrets (original report).

Probably increased with gun stations in wings controlled remotely from fuselage turret for sighting.

LEE

**Distribution:**

Secretary of War  
State Department  
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Assistant Chief of Staff, G-2  
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Air Corps

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**SECRET**

RESTRICTED

G-2/2657-220; No. 394

M.I.D., W.D.

12:00 M., May 17, 1941.

SITUATION REPORTI. Western Theater.

Air: German. Subnormal offensive activity over Great Britain last night, involving 100-200 planes. Principal effort against Birmingham and other Midlands industrial centers.

British. Normal night operations, involving about 125 bombers. Main attack was made on Cologne. The invasion coast also was attacked.

II. Mediterranean and African Theaters.

Ground: North Africa. Axis troops have recaptured Sollum and other positions on the Libyan-Egyptian frontier which the British had retaken.

East Africa. British troops are reported to have reached Adola, 50 miles north of Neghelli, in southern Abyssinia (Ethiopia).

Air: Axis. Close support in the Sollum area. Raids on Malta and Crete.

British. Harassing raids in Libya.

III. Middle Eastern Theater.

Iraq: Desultory air and ground fighting.

Syria: Unconfirmed reports of British-French border clashes. The R.A.F. continued small-scale raids on Syrian airdromes.

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## TREASURY DEPARTMENT

## INTER-OFFICE COMMUNICATION

DATE May 17, 1941

TO Secretary Morgenthau

FROM Mr. Cochran

**STRICTLY CONFIDENTIAL**

Assistant Secretary of War McCloy called me at 1 o'clock today. He referred to the \$230,000,000 program on supply contracts. He said that his Ordnance people had "taken out" \$49,600,000 of the above amount, using Ordnance funds therefor. He said these represented the only contracts in the \$230,000,000 program which the British had entered into prior to the Lend-Lease legislation. He assumed that anything beyond the \$49,600,000 would have to be taken care of under Lend-Leasing.

He referred to the plant facilities program as amounting to \$133,000,000. Through the R. F. C. the Army has already "taken out" \$48,300,000. The R. F. C. finances this, although the Ordnance people must eventually repay R.F.C. McCloy is still working on the difference of \$85,000,000 between the \$48,000,000 and the \$133,000,000. He is trying to get either the Ordnance or the R.F.C. to take over all of this difference. The Ordnance itself might have enough money for all of this, but McCloy thought it much preferable that the Defense Plant Corporation do the transaction, since an immense amount of legal work is necessary which Jones is in a better position to perform than is the War Department. The Army is prepared to certify that all of the plants should be taken over for national defense, whether by R. F. C. or Ordnance.

McCloy has consulted again with Secretary Stimson, since last talking with Treasury people on the subject, and the Secretary of War feels very definitely that the Army should not go ahead and take the British out of more supply contracts unless instructions from the White House are received. They feel that they need such instructions, particularly in the light of the testimony given to Congress by the Budget Director.

Referring to the \$49,600,000 item, Mr. McCloy pointed out that this is the face amount of the contracts of which the British are being relieved. The Army negotiates new contracts replacing these. It is up to the British, therefore, to negotiate with the manufacturers to see how much cash is refunded to them on such contracts.

In summary, Mr. McCloy asked that I tell Secretary Morgenthau that the War Department wants to go as far as possible in assisting him, and in relieving him of the commitment to take care of \$300,000,000 to \$400,000,000 which he had undertaken. They feel, however, that they cannot themselves go beyond the \$49,600,000 on supply contracts without a definite clearance from the White House. I told Mr. McCloy that I would speak with both Secretary Morgenthau and Under Secretary Bell and that one of us would call him back if any further information is required.

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May 19, 1941

At 2:30 this afternoon I talked with Mr. McCloy by telephone to confirm that I had the above story correct. McCloy reiterated that he is going ahead to see what can be done further on plant facilities. He said that there was a meeting held this morning by the Ordnance, Air Corps and other Services to see if there is anything further any of them can do. A decision will be reached on this point within the next day or so.

A handwritten signature in dark ink, appearing to be 'J.M.P.', is centered on the page below the typed text.

May 17, 1941.

Memorandum for the President:

Reference is made to your memorandum of May 14th with which you transmitted a copy of a communication addressed to you by Senator Millard E. Tydings with respect to certain matters of appointment in the State of Maryland, both under the Department of Justice and under the Collector of Internal Revenue of the Maryland District.

Of course, this Department is without knowledge of the situation with respect to appointments under the jurisdiction of the Department of Justice. In view of the fact that Collectors of Internal Revenue are held responsible under heavy bond for the faithful performance of their duties, this Department has taken the position that it should consistently refrain from interfering with the Collectors in their right to appoint Deputy Collectors who are competent and qualified in every way to perform their duties. Of course, the Department has exercised its right to reject any recommendation the consummation of which would be contrary to the best interests of the Government. This practice has proven to be a proper one under the method of appointments prescribed by law for Deputy Collectors.

The matter of Senator Tydings' inquiry has been brought to the attention of Collector Magruder. Information has been received from the Collector to the effect that when it became necessary to appoint additional Deputy Collectors for the important work of administering the increased duties imposed upon his office by the Revenue Act of 1940, he did not invite Senator Tydings to submit recommendations for the appointment of this additional personnel. The Senator states that he has made no recommendations to the Collector's office since the primary campaign of 1938. The Collector indicates that this is literally true. It is Collector Magruder's position that inasmuch as the Senator submitted

-2-

recommendations concerning appointments prior to 1938 without invitation from him that no invitation was necessary subsequent to that time. The Collector further indicates that he would have been willing to have given consideration to any recommendations submitted by the Senator inasmuch as his first concern was to secure the services of persons properly qualified to perform the duties. Furthermore the Collector states that if the Senator will submit to him the names of properly qualified persons whom he would like to have considered for appointment in the Maryland District he will give appropriate consideration thereto whenever vacancies occur.

(Signed) W. Berghaus, Jr.

Secretary of the Treasury.

By Messenger 3:45 P.M.

File to Mr. Thompson

MAY 20 1941

**Memorandum for the Attorney General:**

I send you the attached memorandum of May 14 addressed to us jointly by the President asking for the preparation of a reply to Senator Tydings' letter of May 7 addressed to the President.

I am also sending forward a memorandum to the President, which I have signed, advising with respect to the appointment of deputy collectors of internal revenue.

I assume that you will prepare a reply to Senator Tydings' letter covering the appointments under the jurisdiction of your department and the information contained in my memorandum may be used with respect to deputy collectors of internal revenue.

(Signed) H. Morgenthau, Jr.

Secretary of the Treasury.

WFT:ans

Encls:

Memo of May 14th and its enclosure  
copy of Secy's memo to President dated 5/17/41

File to Mr. Thompson

By Messenger *4<sup>th</sup>*

THE WHITE HOUSE  
WASHINGTON

213

May 14, 1941.

MEMORANDUM FOR SECRETARY MORGENTHAU ✓  
AND THE ATTORNEY GENERAL:

For preparation of reply.

F. D. R.



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these places. Several of the Congressmen, knowing I had not been consulted in this matter, offered to give me a part of their allotment.

However, for the record, I did not accept their offers as I was not included among those asked to make recommendations to the Collector.

Indeed, I cannot recall that I have made any recommendations to the Collector's office since the primary campaign of 1938.

Please understand, Mr. President, that I am not making the slightest complaint to you about the above. I am simply stating the facts quite frankly, to ascertain whether or not, now that these matters have been called to your attention, it is your wish for this procedure to continue. My main thought in writing is to request that you kindly advise me what the patronage situation is in Maryland, so I may advise those who apply to me accordingly.

I regret to bring such a matter to your attention in such troublesome times, and have refrained from doing so until I felt, in justice to myself and those I was elected to represent, I had no other course.

Trusting this finds you in good health, I

am

Respectfully yours,

*Millard E. Eby*

1-m

May 17, 1941

## MEMORANDUM

To: The Secretary  
From: Mr. Blough  
Subject: Excess profits tax proposals of Mr. Eccles  
and Mr. Henderson

1. Memorandum from Mr. Eccles to the President,  
April 22, 1941

In this memorandum no figure was given for the desirable increase in tax yield from the excess profits tax. The excess profits credit should be no more than 10 percent or less than 6 percent of invested capital, the exact figure between those limits to be determined by past earnings experience. Rates should be increased as follows: 25 percent on the first \$20,000, 50 percent on the next \$25,000, and 75 percent on the remainder of excess profits.

2. Testimony of Mr. Eccles before Ways and Means  
Committee, May 7, 1941

The first source of defense revenue should be the corporation tax and the excess profits tax. Additional revenue of \$800 million to \$1 billion should be raised from the excess profits tax, in comparison to the

- 2 -

Treasury recommendation of \$400 million. The income method of computing the excess profits credit should be restricted either by reducing the 95 percent average earnings now allowable to 75 percent or by some other method. The invested capital credit should be reduced from 8 to 6 percent. The rates of tax should be increased sharply and a maximum rate of 75 percent is not too high. The maximum rate should apply to excess profits at a very much lower level than \$500,000.

3. Testimony of Mr. Henderson before Ways and Means Committee, May 7, 1941

The excess profits tax can and should be one of the main pillars of this year's revenue act. Small business should be exempt with perhaps a \$25,000 income exemption. A ceiling of 10 percent of invested capital should be provided under the average earnings method and the percentage of invested capital should be reduced to 6 percent of equity capital (eliminating borrowed capital). A five-year carryover of losses should be allowed. The rate of tax ought to be raised (but no rate was suggested).

NRB

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON

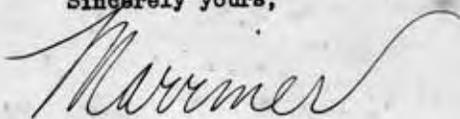
OFFICE OF THE CHAIRMAN

April 24, 1941.

My dear Henry:

In accordance with our telephone conversation of yesterday afternoon, I am enclosing (1) a copy of the memorandum with regard to taxation together with the accompanying letter to the President, and (2) the letter and two accompanying memoranda on the bank holding company situation.

Sincerely yours,



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

enclosures

C o p y

April 22, 1941.

My dear Mr. President:

At your suggestion, Mr. Sullivan of the Treasury briefly outlined to me the Treasury's tax program. As a result of that conference and of previous extensive studies made of the tax problem, I have prepared a tax program as outlined in the enclosed memorandum. It is similar to the Treasury's proposals both as to its total yield and in the general revenue sources on which it draws.

It differs materially, however, in the method of computation of excess profits and the tax rates thereon, the Treasury's proposal, in my opinion, being entirely inadequate.

The proposals in the attached memorandum call for less revenue from individual surtaxes and certain excise taxes, which are offset by a greater revenue from excess profits tax.

Respectfully yours,

The Honorable  
The President of the United States,  
The White House.

April 22, 1941  
MK-JD

### A TAX PROGRAM

Excess Profits Tax - The present statute, falling far short of the intention stated in the President's message of July 1, 1940, "to see that a few do not gain from the sacrifices of the many" in the task of arming for national defense, should be drastically revised. Labor can not well be asked to moderate its demands if employers are permitted to retain huge profits. After paying taxes reflecting increases already made and in prospect, many individuals will have less money left than they had before the defense program got under way; meanwhile, many corporations are making more money, even after taxes, than they ever made before. In contrast to individual earnings, these corporate earnings escape the full force of the individual surtaxes because they may be retained without penalty. An effective excess profits tax is the best way to make them bear their fair share of the tax load.

Specific Proposal - Fix the excess profits base at not more than 10 per cent or less than 6 per cent on invested capital, the exact figure within these limits to be determined by past earnings experience. Retain the present specific exemption of \$5,000. On excess profits over this exemption, levy rates as follows: 25 per cent on the first \$20,000; 50 per cent on the next \$25,000; 75 per cent on the remainder of excess profits. Retain the provisions of the present law providing for special treatment of hardship cases.

Special Defense Tax on Corporate Income - Raising the rate of normal corporate income tax would increase the value of the tax exemption privilege on income from over \$20 billion of outstanding Federal Government securities. In order to levy upon such income, enjoying immunity from normal tax but not from surtaxes, a fair share of the increased tax burdens which the community at large will be called upon to pay, a defense surtax on corporate income of 6 per cent, in addition to the present normal rate of 24 per cent, is proposed.

Personal Income Tax - This is the most equitable of all taxes and should be made the backbone of our tax structure. Up to now, however, we have failed to make the full use of the personal income tax as other democratic countries have done, with the result that it yields only about 20 per cent of total Federal revenue. Pressures on Congressional Committees have resulted in an income tax statute shot through with inconsistencies, inequities and immunities for minority groups of taxpayers.

Specific Proposal - (a) Tax the incomes of husbands and wives as a single income. The privilege of filing separate returns is a tax-avoidance device that in practice is valuable only to wealthy couples, and practically all wealthy couples make use of it. Professional services of a high order at the Government's disposal are adequate to remove the legal obstacles to this proposal.

(b) Lower the present personal exemption of \$2,000 for married persons to \$1,000. The revenue thus obtained from the better paid wage-earners, together with existing and proposed consumption taxes paid by this group, will go far toward making good possible losses in excess profits revenue if governmental price-control in combination with rising wage rates, should restrict the growth of profits.

(c) Eliminate the present \$4,000 surtax exemption, but continue to allow deduction of personal exemption (reduced as proposed above) and credit for dependents for surtax purposes. Since an increase in the normal tax would increase the value of the tax-exempt privilege borne by outstanding Federal securities, increased revenue from the individual income tax should be obtained primarily by increasing the surtax rates. Accompanying upward revision of surtax rates the Defense Tax, amounting to 10 per cent of the tax computed at present scheduled rates, should be eliminated. The proposed schedule of rates is shown in Appendix A.

Estate and Gift Taxes - On June 19, 1935, the President said "The transmission from generation to generation of vast fortunes by will, inheritance or gift, is not consistent with the ideals and sentiments of the American people. Such inherited economic power is as inconsistent with the ideals of this generation as inherited political power was inconsistent with the ideals of the generation which established our government." The task of bringing law into conformity with popular ideals, begun in the Revenue Act of 1935, ought to be finished now.

1. Establish a single schedule of rates applicable to the cumulative total of gifts during life plus estate passing at death. Under present practice, gifts subject to tax in the lowest brackets of the gift tax can be used as a means of avoiding taxes in the highest brackets of the estate tax. Great accumulations of wealth can be transmitted by gift as well as by bequest, and a consistent public policy would tax both types of transfer at the same effective rates. Raise the now unduly low rates applicable to estates under \$10 million. The proposed schedule of rates is shown in Appendix A.

2. For the present exemptions of \$40,000 under the gift tax, \$40,000 general under the estate tax, and \$40,000 insurance under the estate tax -- a total of \$120,000 -- substitute a single exemption of \$25,000.

3. Broaden the legal concepts of "gifts" and "transfer at death" so that the estate tax will effectively reach all transfers of property that transmit wealth from one generation to the next. Transfers from life tenant to remainderman are among the widely used devices for avoiding estate tax.

4. Limit the right to make tax-exempt gifts and bequests to educational and charitable institutions either by limiting the amount of such transfers or by requiring the gift or bequest to be certified as truly in the public interest by qualified expert opinion. Such transfers often merely reflect the whims of the donor and serve no useful public purpose.

Excise Taxes - The following excise taxes would fall largely on goods requiring the use of scarce materials and skills needed for the defense program.

	<u>Proposed rate</u>	<u>Existing rate</u>
	(Per cent of manufacturers' price)	
Passenger automobiles and motorcycles	20	3.5
Automobile parts and accessories	15	2.5
Radio sets	11	5.5
Mechanical refrigerators	11	5.5
Firearms, shells, pistols, revolvers	25	11

	(Specific rates)	
Gasoline	2¢ per gal.	1.5¢ per gal.
Tires	3.0¢ per lb.	2.5¢ per lb.
Tubes	5.5¢ per lb.	4.5¢ per lb.
Luxury goods (furs, jewelry, etc.)	various rates	

Revenue Yield - The yield of these proposals on a full year basis may be roughly estimated as follows:

	(Millions of dollars)
1. Excess profits tax revisions	700
2. Special defense tax on corporate income	600
3. Individual income tax:	
(a) Tax incomes of couples as a single income	225
(b) Lower married persons exemption to \$1,600	100
(c) Raise surtax rates and lower exemption	700
4. Estate and gift tax	500
5. Excise taxes	625
	3,450

## APPENDIX A

## EXISTING AND PROPOSED SURTAX RATES

Surtax net income (Thousands of dollars)		Rate (per cent)		Surtax net income (Thousands of dollars)		Rate (per cent)	
		Existing	Proposed			Existing	Proposed
0 to	2	0	4	50 to	60	44	52
2 to	4	0	7	60 to	70	47	54
4 to	6	4	10	70 to	80	50	56
6 to	8	6	13	80 to	90	53	58
8 to	10	8	16	90 to	100	56	60
10 to	12	10	19	100 to	150	58	62
12 to	14	12	22	150 to	200	60	63
14 to	16	15	25	200 to	250	62	64
16 to	18	18	28	250 to	300	64	66
18 to	20	21	31	300 to	400	66	67
20 to	22	24	34	400 to	500	68	68
22 to	26	27	37	500 to	750	70	70
26 to	32	30	40	750 to	1,000	72	72
32 to	38	33	43	1,000 to	2,000	73	73
38 to	44	36	46	2,000 to	5,000	74	74
44 to	50	40	49	5,000 and over		75	75

## EXISTING AND PROPOSED ESTATE TAX RATES

Net Estate		Rate (per cent)		Net Estate		Rate (per cent)	
Exceeding	Equalling	Existing	Proposed	Exceeding	Equalling	Existing	Proposed
(\$000)				(\$000)			
	10	2	3	1,000	1,500	32	46
10	20	4	6	1,500	2,000	35	49
20	30	6	10	2,000	2,500	38	51
30	40	8	12	2,500	3,000	41	53
40	50	10	15	3,000	3,500	44	55
50	70	12	18	3,500	4,000	47	57
70	100	14	21	4,000	4,500	50	59
100	150	17	25	4,500	5,000	53	61
150	200	17	25	5,000	6,000	56	63
200	250	20	30	6,000	7,000	59	64
250	400	20	30	7,000	8,000	61	65
400	450	23	35	8,000	9,000	63	66
450	600	23	35	9,000	10,000	65	67
600	750	26	39	10,000	20,000	67	68
750	800	26	39	20,000	50,000	69	69
800	1,000	29	43	50,000	- - -	70	70

Note: Under existing law "net estate" is computed by deducting a specific exemption of \$40,000; under the proposed law the specific exemption would be reduced to \$25,000.

## TREASURY DEPARTMENT

## INTER OFFICE COMMUNICATION

DATE May 17, 1941

TO Secretary Morgenthau  
FROM Herbert Merillat

TOO MANY TAX PLANS

The semblance of political unity that existed with respect to the 12<sup>1</sup>/<sub>2</sub> billions revenue goal has now disappeared. The anti-Administration press is in full cry, accusing the Administration of demagoguery in not recommending a broader income tax base and in failing to push reductions in non-defense appropriations.

Confusion is also evident, resulting from differences between tax plans presented to the Ways and Means Committee. The press tends to snipe at details of the various tax plans without attempting to make constructive suggestions for an over-all tax program.

Broadening of the income tax base continues to be the change most frequently suggested, and advocates of this step take heart from Eccles' support. Erroneous statements are frequently made that Henderson, too, urged lower exemptions.

Possible changes in the excess profits tax get relatively little attention, probably because that complicated subject is little understood. Altogether the volume of press comment on Federal taxes has slackened perceptibly.

### The Henderson and Eccles Proposals

The Henderson and Eccles proposals were more favorably received in the press than the Treasury plan, generally on the ground that they recommended lower exemptions from the income tax and less heavy increases on lower-bracket incomes than the Treasury proposed. The press generally predicts that the tax bill to be reported by the Ways and Means Committee will not bear as heavily on lower-bracket taxpayers as the Treasury had suggested. Even the liberal papers and journals which spoke kindly of the Treasury plan are inclined to favor the Henderson-Eccles plan, because the latter places more emphasis on excess profits taxes and less emphasis on excises. All sections of the press, moreover, are impressed with the Henderson-Eccles attempt to relate taxes to the defense production program. Incidentally, the Henderson-Eccles proposals are widely regarded as representing the Administration's real views on tax policy.

### The Keynes Plan

The arrival of Keynes in this country has revived speculation on the possibility of adopting a forced savings plan in this country. Ernest Lindley urges adoption of such a plan. John T. Flynn sees some merit in it as a means of avoiding immediate inflation, but fears that inflation would come when the savings were repaid to taxpayers.

## 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
15	16,984	4,255	1,952	10,777	1,116	15,867	3,139	1,952	10,777	91
16	17,470	4,062	1,528	11,880	1,054	16,415	3,007	1,528	11,880	102
Total	\$249,245	\$ 52,765	\$ 27,775	\$168,705	\$ 19,814	\$229,431	\$ 32,951	\$ 27,775	\$168,705	\$ 2,246

Treasury Department, Division of Research and Statistics.

May 17, 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.

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Regraded Unclassified

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No. 13 (1039/106/41)

Safe Hand.

BRITISH EMBASSY,

WASHINGTON, D. C.

May 17th, 1941.

Dear Cochran,

On the 21st March I sent you a note of the decision reached in London with regard to the purchase by our enemies of dollar bonds and Standstill Claims. Since then the matter has again been under discussion with London in view of complaints received by us from American interests which are concerned to receive some re-payment in respect of what may very well be a wasting asset. London have now asked me to ascertain the views of the U.S. Treasury in this matter, and it seems possible that should the Treasury regard it as desirable that no obstacle should be placed in the way of sales to Germany of bonds and Standstill claims, London would be prepared to re-consider their decision. I should therefore be grateful if you would be kind enough to let me know your views.

Yours sincerely,

(Signed) R. J. Stepford

Mr. Merle Cochran,  
U. S. Treasury Department,  
Washington, D. C.

dm

W. T. 514/94/41.

Safe Hand.

BRITISH EMBASSY,

WASHINGTON, D. C.,

May 17th, 1941.

Dear Cochran,

When we were discussing the other day the question of the Banks doing German or Italian business, I did not mention one aspect of this, namely, the transaction of business with firms on our Statutory List, especially in South America. My attention has recently been called by Montevideo to such cases. In the first case, the Second National Bank of Boston at the end of March, issued an irrevocable credit for \$6,000.00 in favour of Laheusen & Co. Ltd. of Montevideo for account of Walker & Co. Inc. of Boston, covering shipment of 20,000 pounds of wool to Boston.

In the second case, the Bank of the Manhattan Company of New York at the end of March opened an irrevocable credit in favour of Staudt & Co. of Montevideo for account of the Cleveland Worsted Mills Company of Cleveland for \$50,000.00 shipment of 125 barrels of wool to Cleveland.

As you know, the State Department are interested at the moment in this question of the use of enemy firms in South America by United States commercial firms, and I would hope that it might not be an unsuitable moment to attempt to discourage the New York banks from giving credits in such cases.

Yours sincerely,

(Signed) R. J. Stopford

Mr. Merle Cochran,  
U. S. Treasury Department,  
Washington, D. C.

## TREASURY DEPARTMENT

## INTER-OFFICE COMMUNICATION

DATE May 17, 1941

TO Secretary Morgenthau

FROM Mr. Cochran

**CONFIDENTIAL**

Registered sterling transactions of the reporting banks were as follows:

Sold to commercial concerns	£9,000
Purchased from commercial concerns	£8,000

Open market sterling held steady at 4.03-1/4. Transactions of the reporting banks were as follows:

Sold to commercial concerns	£9,000
Purchased from	-0-

In New York, closing quotations for the foreign currencies listed below were as follows:

Canadian dollar	12-11/16% discount
Swiss franc	.2320-1/2
Swedish krona	.2385
Reichsmark	.4005
Lira	.0505
Argentine peso (free)	.2375
Brazilian milreis (free)	.0505
Mexican peso	.2070
Cuban peso	2-5/16% discount

In Shanghai, the yuan was again unchanged at 5-11/32¢, and sterling remained at 3.90-7/8.

There were no gold transactions consummated by us today.

No new gold engagements were reported.



Address delivered at the Citizenship Day  
Ceremonies in Milwaukee, May 13, 1941

By Lloyd K. Garrison

About a hundred years ago a young German, Carl Schurz, came to this country and to this city in search of democracy. He found it, and later on he summed up his gratitude in these words:

"I, born in a foreign land, pay my tribute to Americanism? Yes, for to me Americanism, true Americanism, comprehends the noblest ideas which ever swelled a human heart with noble pride."

What were these ideas which in Carl Schurz's mind were the essence of Americanism?

First, surely, the idea of freedom: freedom of opportunity, freedom of worship, freedom of speech and press, freedom for the expression of views we hate as well as those we like, freedom from action by government officials save in accordance with the law of the land -- all these and other freedoms, guaranteed by the Bill of Rights of our constitutions, state and federal.

Secondly, government of the people, by the people and for the people, subject always to the guarantees of the Bill of Rights.

Thirdly, the idea of the worth of a man regardless of race, color or creed; the idea which has given us our great public school system and has made us strive in countless ways for the enrichment and protection of the individual life.

These were the ideas which America stood for in Carl Schurz's day. These are the ideas which America stands for today. These are the ideas which I hope will swell your hearts with pride, as they did Carl Schurz's. These are the ideas which I hope as citizens you will try to make come true. For they have never wholly come true in practice. There is yet in our country much injustice, inequality, greed and selfishness.

But we have marched further toward democracy than any other people. And the brave men who wrote the Declaration of Independence, fought the revolution, and created the Constitution of the United States, reared a fabric of government which has sheltered in freedom more people, over a wider area and through a longer stretch of time, than any other institutions ever made by man. So I say that with all our faults we have much to be proud of, and that you who have just become citizens may thank the fate that made you Americans.

But we must think of our future as well as our past. Today throughout the land one thought is uppermost in the minds of everyone; the war and our relation to it. Nowhere else on earth are free citizens freely debating the issue of whether to fight, or to stay at peace, or to adopt some middle course. We as citizens have both the right and the duty to decide these issues. In our hands lies the fate of our country, and perhaps the fate of the world. To think through the issues that face us and to take a stand -- that is the task of citizens in a democracy. On this day devoted to the meaning

of citizenship, we can no more avoid discussing these issues than we can avoid thinking about them.

The questions before us are not the same as we faced in the last war. The world of 1917 has gone with the men who made and marred it. A new generation of leaders, hardened in war and frustrated in peace, has seized command in Europe. They have turned their back on the past, on its good as well as its evil. They were the first to perceive that war could be waged in peace-time, secretly, in the heart of an enemy's country. They were the first to perceive that the old tactics of war had been junked by the latest machines of science. Armed with these machines they swept to victory.

As a result of the new machine warfare, two gigantic shifts in the distribution of the world's power have already occurred. Each vitally concerns us. The first has resulted from the development of swift, wide-ranging and armored bombing planes. This development has permanently decreased the value of sea power, on which America and Britain have relied for defense. Our influence in the world, as well as our safety, has depended on sea power; and because of our sea power we have gotten along without great standing armies, and have been able to concentrate on peaceful pursuits. But now the new navies of the air have made the navies and merchant ships of the sea weaker and less effective. This shrinkage in our sea power has been made more serious by the elimination of the French navy, by the use of the French, Belgian, Dutch, Danish and Norwegian coasts as naval and air bases, by the unification of Europe under one ambitious military organization, and by understandings between the latter and the dictators of Asia.

As a reaction to these momentous changes, Great Britain and America have entered into a naval and military association which seems destined to continue after the war is over. The defense of Canada has been guaranteed by our government; I assume that we are prepared also to defend Australia and New Zealand; Congress by overwhelming majorities has declared the defense of Britain to be a vital concern of America; we are giving and lending to Britain all manner of planes, munitions and ships; we are exchanging military secrets; we are manufacturing guns, shells, motors and the like according to common specifications; we are operating our ships and naval vessels according to a common plan; and we have acquired and are fortifying ninety-nine year naval bases on British islands in the Atlantic and on the Canadian shore. It seems to me almost certain that under these circumstances our collaboration for defense will be permanent. This collaboration has been a perfectly natural development. Once the position of the sea power democracies had been weakened by the new air forces of the land powers, it was inevitable that the sea power democracies should draw together in some form of association for mutual defense. This drawing together was facilitated by a common language, by common ways of thought, and by trust in one another's purposes.

The second great shift in the distribution of power has resulted from the mechanization of armies. The modern tank and plane have put the foot soldier and the fort out of business, with the consequence that military domination no longer turns on numbers of men and fortifications, but on the capacity to manufacture tanks and

planes. The further consequence is that Germany, as the greatest manufacturing country next to ourselves, has become the military master of Europe. This mastery can no longer be challenged within Europe. It can only be challenged by attackers from outside. It is almost certain to be permanent unless destroyed from outside. Whether it can be destroyed or not from the outside no one can surely say. Those who are strongest for war believe that if America went in all the way, air superiority over Germany could finally be won, and that that would end the Nazi power. I do not know whether this could happen or not. I only know that the last war continued four years with all the world against Germany, and that now the German position, both economic and military, seems to be much stronger than it was before. And I know that war has a way of deluding men's minds and filling them full of false hopes, so that they are all the time believing that somehow victory lies just around the corner, when in fact it is far away and to be had only after such hideous suffering that when it finally comes it is more like defeat than victory. I am convinced that mankind would in the end be the loser if we were to try to carry through to the bitterest end the reconquest of Europe. And I say this as one who hates the Nazi creed to the depth of his being.

I believe that the foreign policy of America ought to be based on a recognition of the two world changes which I have just described, namely (1) the decline of sea power, and the consequent drawing together of the sea power democracies for mutual protection, and (2) the military dominance in Europe of the dominant manufacturing country.

If my conviction is right that, as a result of the decline in sea power, we have embarked on an association with the other sea power democracies which is destined to be permanent, the sooner we realize that fact and the sooner we lay our plans accordingly, the better off we shall be. I think we should plan not only for the present -- as in fact we are now doing -- but, so far as possible, for the future, when peace returns. For our association can and should have objects broader than that of mutual self-defense. It should be designed to promote the freest possible interchange of goods and services and capital and people. It should be designed to avoid trade rivalries in the markets of the world. It should be designed to encourage all efforts toward maintaining the peace of the world. Such an association need involve no loss of American sovereignty; and in its councils we would have a controlling voice by right of our size and population. Australia, New Zealand, Canada, South Africa, Ireland, Great Britain, the United States -- these sea power democracies, teamed together, could be a potent force not only for defense, but for building a better world in peace.

Many people have been brought up on the idea that America must at all costs stand alone in the world and attend to her own business. I realize the strength of that idea and the sincerity of those who believe in it. What I have tried to suggest is that, whether we like it or not, that idea has been buried under the bombs of the new air fleets and that we have already in fact become part of

a new grouping of nations. Our job as intelligent citizens is to accept that fact, and to turn it to good ends, both for ourselves and for mankind.

Secondly, if my conviction is right that German dominance in Europe can be destroyed, if at all, only by a struggle which will also destroy what little is left of western civilization, it follows that the policy of the associated sea power democracies ought to be policy of defense only. They (and by "they" I include America) should jointly declare that their object is not to reconquer Europe by force of arms, but to defend their shores, their bases and their island possessions now and hereafter. They should jointly declare that they will vigorously oppose attempts by the totalitarians to seize further portions of the earth's surface. They should declare themselves ready to join with the dictators in an immediate cessation of the fighting. Such action would not require the democracies to make a peace treaty with the dictators. Wars are now begun without formal declarations, and they can be ended without formal treaties. The two sides would simply agree to stop fighting and to stay where they were, pending the negotiation of a permanent treaty later on. Some minimum and immediate adjustments of territory would of course be necessary. But this could be done without a detailed treaty, and without acknowledging that what had been done in Europe was approved.

When the irreparable waste of fighting is stopped, powerful forces in Europe, kept down in war, will begin to assert themselves. The pressure of all the conquered countries for local self-government will every day be felt. The political difficulties of administering so vast and varied a territory, with so many diverse races and traditions, will multiply with peace. And within the ranks of the victors profound psychological and moral reactions, long suppressed and stifled, are likely to occur. Ultimately a government or governments should evolve which the western world could trust and approve, and with which a final peace treaty could be made.

If it were necessary to wait some time for this, the associated democracies could wait. Banded together in peace, they could build plane for plane and ship for ship and defend themselves against the possibility of further attacks.

A definitive peace treaty, when finally negotiated, should go deeply into such questions as colonies, disarmament and collective security. Negotiated in a time of calm, it might be able to bring about what the Treaty of Versailles in a time of hate failed to bring about, namely, a true international new order. It would seek to remove inequalities and injustices, to restore wrongly taken possessions, and to build agencies for improving the lot of mankind and for settling disputes between nations.

I realize that the mere suggestion of stopping fighting and leaving the dictators in command of Europe is abhorrent to those who can think only in terms of crushing the men who have wreaked so much cruelty upon others. To stop short of that goal is called appeasement and defeatism. I am as anxious as anyone to rid civilization of the men who have trampled on its noblest ideals; but I am

that those very men are at their strongest in war and that in peace they are less likely to survive. The genius of fascism is in war and not in peace, just as the genius of democracy is in peace and not in war. And that is why I want the sea power democracies, America, Canada, Australia, New Zealand, South Africa, Ireland, Great Britain, to declare that they are banded together for defense only, for peace now, for the long pull hereafter, for the building of a happier, safer and more fruitful world.

If in the face of such a declaration the totalitarians were unwilling to stop fighting, they would be serving notice publicly and unmistakably that their aim was nothing less than the conquest of the world. In that case there would be no other course but to go on fighting them. And it would then seem to me wholly in the interests of America, and in the interests of mankind, for us to join the struggle with every naval and air resource at our command.

In suggesting this program I am acutely conscious of my own limitations of knowledge. I know how hard it is for even the best informed and most expert judges to see clearly in the midst of so much rapid change and so many unpredictable events. But of one thing I am absolutely sure. We need desperately at this very moment to be discussing our ultimate goals and the kind of post-war world we wish to bring about. For the danger is that before we have thought through these matters and decided exactly where we are going and why, we shall drift or be drawn actively into the war, and that once the war fever grips us we shall lose altogether the capacity to think clearly.

In the state of mind which war induces we shall blind our eyes to all realities, let loose in our souls the vials of hate and fear, and persecute in the name of patriotism all who stand aside from the universal frenzy. And in that state of mind we shall carry the war forward to the bitterest end, with bombings and sinkings and ever more bombings and sinkings, and the crumbling to bits of once noble cities, and the indiscriminate slaughter of men, women and children, and the slow starvation of many, and the poisoning of the minds of a whole generation of fighting men on both sides, until at last somehow the struggle will end and the stage be set for social convulsions the world over and for all the terrible aftermath of war - the decline of morals, the corruption of government, the dissolution of standards and traditions, the rise of demagogues, and the destruction of everything which is precious to the spirit of man.

All this I fear if we embark upon war with no other object than that of crushing Germany. If in the end we were to succeed, if by fire and sword we were to bring about at last the collapse of the Nazis, neither the British, half destroyed themselves in the process, nor ourselves, confronted with appalling problems here at home, would have the energy or will to organize a new order of things in Europe; and the shell-shocked people we had fought to liberate from the Nazi yokes would either find new dictators or be at each other's throats again.

And now I leave you with this final word. Whatever the outcome of the present struggle, the strains which our government will have to face when it is over will exceed any that have ever yet been placed upon it. We shall surely have to make crucial and continuous decisions in matters of foreign policy as well as in domestic. We shall emerge as the dominant partner in the English-speaking world, with all the immense responsibilities that that implies. With the deflation of war production, we shall have, unless we act with extreme boldness, an economic crisis perhaps more formidable than any in the past. As happened after the last war, men will ask how it is that the economic machine can function at full blast for purposes of destruction but can operate at only half speed for purposes of construction. And we shall have to answer that question at our peril.

The upshot of all this is that upon you, fellow citizens, the heaviest duties will be laid. For citizenship, as I have said, consists not only of rights but of duties; and the duty to vote and the duty to bear arms are by no means all that is expected of you. You are under a duty to learn, to think, and to speak up. You are under a duty to keep cool, and not let yourself be swept by the gusts of passion and prejudice. You are under a duty to judge men and actions by the eternal tests of truth, honor, justice, decency, and magnanimity. For the foundation of national well-being is in these virtues, and not in sticks and stones.

And now I charge you: stand up; acquit yourselves as free-men in this the greatest democracy the world has ever known; be masters of your fate; and lift up your eyes to the horizon, for a better day is dawning if only you will rend the clouds that darken it.

5/19/41 Sunday  
at  
12 noon  
Acee's  
house

STATEMENT OF JOHN L. SULLIVAN, ASSISTANT SECRETARY  
OF THE TREASURY, BEFORE THE COMMITTEE ON WAYS  
AND MEANS OF THE HOUSE OF REPRESENTATIVES,  
MONDAY, MAY 19, 1941

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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

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great sacrifices must be made and they are prepared to make them. They rely upon you 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. All must be viewed, however, as parts of a whole. This is an emergency. Taxes that would not be proposed in normal times are a necessity now.

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 tax 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,

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although some of those profits are excess profits by any reasonable standard. 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, in a period of this kind, should 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 identify 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 such excess profits to be made, it is equitable and desirable that they 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 additional 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 must remember that no legislation is ever passed and no progressive step is ever taken which does not disturb expectations 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 which is now to be subjected to a much heavier 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 industrial 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

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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 subject to the tax unless such profits also represent an increase over the profits of the base period. Companies which earned during the base period an average of 30 percent, 50 percent or even more on their present invested capital will be free from the excess profits tax on income in any year equal to approximately these percents and will be taxable only on increases in their incomes.

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 free of the excess profits tax an amount of earnings equal to 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 business is to expand and investors are to put money into new corporations, an opportunity must be allowed to earn an adequate rate of return on new capital. The plan allowed an 8 percent return on new capital, with a 10 percent return up to \$500,000, regardless of the earnings experience during the base period on old capital.

If the plan submitted by the Treasury last year had been applied to the examples previously presented, the tax results would have been quite different. For example, one corporation which had a 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 industrial company which received over \$250 million of defense contracts 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

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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

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rates. This minimum rate of tax would subject all increases in profits during the defense period at least to some excess profits taxation without unduly burdening concerns whose increased earnings are not truly defense profits.

We would suggest also that the rate allowed on new capital be the same as that originally suggested, namely, 8 percent, with 10 percent up to \$500,000. 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 profits 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 starting with a moderate initial rate.

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 and take the risk of finding ourselves confronted with the necessity of improvising such a base on short notice at a later date.

Thus far I have outlined the principles of excess profits taxation which in our opinion should be followed in this emergency period and have indicated ways in which the existing law fails to carry them out. If you share our belief in these principles, I believe you will agree that a plan like 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 taxes both defense profits and excess profits, which the present law does not do.

#### IV. Possible alternative

If these principles are not to be the guide for taxing corporations during the emergency period, it

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would be well to bear in mind the disadvantages of the tax in its present form, which involves the administrative difficulties inevitably accompanying excess profits taxation but fails to tax large amounts of profits that it properly 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.

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 of individuals. Profiting from 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.

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.

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When I first appeared before the Committee in executive session and discussed this tax program with you generally, I told you that I thought there were certain types of durable commodities, such as electric refrigerators, automobiles, watches, clocks, and cameras, the reduced consumption of which would be helpful to national defense, not only because the plants are adaptable to defense work, but also because the materials used in these commodities are used in defense articles and the workmen who manufacture these things are possessed of the very skills that are needed in many of our defense plants. During those discussions different members of the Committee intimated they thought that taxes on some of these articles should be higher than were recommended and I assured them that we would not object to some increases on these particular articles. Since that time there has been so much discussion about various excise taxes that I think I should repeat to you what I said before -- that I do believe that these articles are the type that it is doubly desirable to tax.

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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 for comparing 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.